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Supreme Court of the United States
OCTOBER TERM, 1987

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Did the court of appeals err in disregarding Natural Gas Policy Act ("NGPA") limits on the Federal Energy Regulatory Commission's ("Commission") authority to interfere with producer contracts?

2. Did the court of appeals err in failing to defer to the Commission's decisions on factual and policy matters which are within the Commission's discretion?

3. Did the court of appeals err in remanding an order of the Commission for failing to consider adequately an issue in this proceeding which the Commission was addressing in other proceedings?

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The undersigned producers of natural gas (Producers)[1] petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (hereinafter "*AGD*").

OPINION BELOW

The opinion of the court of appeals (App. 1a-128a) is reported as *Associated Gas Distributors v. FERC*, —— U.S. App. D.C. ——, 824 F.2d 981 (1987). The Notice of Proposed Rulemaking of the Federal Energy Regulatory Commission ("Commission") is reported at 50 Fed. Reg. 24,130. The order accompanying issuance of the

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[1] Petitioners are listed on the inside cover.

Final Rule by the Commission (Order No. 436) is reported at 50 Fed. Reg. 42,408 (October 18, 1985), 50 Fed. Reg. 45,907 (November 5, 1985) (corrected) and FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,665. App. 129a-144a (excerpts). The Commission's order denying rehearing (Order No. 436-A) is reported at 50 Fed. Reg. 52,217 (December 23, 1985) and FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,675. App. 145a-163a (excerpts). Order Nos. 436 and 436-A were further modified in Order No. 436-B, 51 Fed. Reg. 6398 (Feb. 24, 1986), III FERC Stats. & Regs. (Regs. Preambles) (CCH) ¶ 30,688 (1986); *reh'g denied*, Order No. 436-C, 51 Fed. Reg. 11,566 (April 4, 1986), 34 FERC (CCH) ¶ 61,404 (1986); *reh'g denied*, Order No. 436-D, 51 Fed. Reg. 11,569 (April 4, 1986), 34 FERC (CCH) ¶ 61,405 (1986); *reconsideration denied*, Order No. 436-E, 51 Fed. Reg. 11,566 (April 4, 1986), 34 FERC (CCH) ¶ 61,403 (1986).

JURISDICTION

The judgment of the court of appeals (App. 164a-167a) was issued on June 23, 1987. Applications for rehearing *en banc* were denied on September 15, 1987 (App. 171a). The jurisdiction of this Court is invoked under Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), Section 506(a)(4) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3416(a)(4), and 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Sections 4, 5, 7, 16 and 19 of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. §§ 717c, 717d, 717f, 717o, and 717r, and Sections 311 and 601 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3371 and 3431, are set out in the Appendix to this Petition (App. 173a-196a). The Regulations adopted in the Order No. 436 series are codified primarily in 18 C.F.R. Part 284 (1987).

STATEMENT OF THE CASE

The Commission's Orders below may rank as a "great regulatory milestone of the industry[.]"[2] The Commission seeks to increase competition and facilitate consumer access to market-priced supplies of natural gas. The Commission found that a refusal by an interstate pipeline to transport gas for third parties, where to do so would displace its own sales, is "unduly discriminatory" under Section 5 of the NGA. The Orders below require pipelines that elect to transport gas for others in self-implementing transactions to "unbundle" their roles as both transporters and merchants, and begin operating on an "open-access" basis. The Commission found,[3] and the court of appeals agreed,[4] that the development of a nationwide pipeline network had made it possible for consumers to secure supplies from any region of the country, and that regulatory policies which allowed consumers access to those supplies fulfilled the fundamental purpose of the NGA, which is to protect interstate gas consumers from pipelines' monopoly power. The court of appeals rejected challenges to the Commission's Orders on a wide variety of issues, affirming the Commission's actions as within its discretion to carry out its statutory mandate under the NGA and NGPA.

Nevertheless, the court of appeals remanded these Orders to the Commission on four grounds:

> (1) The Commission was directed to "reassess" its refusal to impose conditions under Section 5 of the NGA deleting or modifying take-or-pay provisions of producer/pipeline contracts still subject to the Commission's NGA jurisdiction.[5]

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[2] App. 17a.

[3] App. 130a.

[4] App. 20a.

[5] App. 90a-91a.

(2) The Commission was directed to reexamine its finding that policy considerations, as well as doubts as to the scope of its legal authority, militated against the imposition of a condition that a producer must offer "credits" against the take-or-pay provisions of its contracts in order to participate in the "open-access" transportation afforded by Order No. 436, and to reach its conclusion by "reasoned decisionmaking." [6]

(3) The Commission had not adequately justified the contract demand reduction provision, which enabled distribution companies and end-users to reduce the quantities of gas which they had agreed to purchase from their pipeline suppliers, in order to allow them to purchase gas directly from producers and transport it under the open-access program.[7]

(4) The Commission had failed to adequately explain the grandfathering of certain transportation programs.

This Petition addresses only the first two grounds for the remand.

Historically, natural gas has been sold under long-term contracts. For decades, natural gas sales contracts have given pipelines or other purchasers exclusive rights to the gas from specific wells or acreage. In return for these commitments, the purchasers assured producers of minimum cash flows by agreeing to take a specific percentage of the dedicated gas or to pay for gas not taken. The contracts further provided that if the pipelines were unable to take the contract quantities of gas, so that the payment provisions were invoked, the pipelines would "make up" the quantities paid for but not taken, at some

[6] App. 94a.

[7] In its "Interim Rule" on remand, Order No. 500, issued August 7, 1987, 52 Fed. Reg. 30,334 (August 14, 1987), the Commission agreed to delete this provision from its program.

later time[8] more convenient to the pipelines. In the gas industry, these contract provisions are called "take-or-pay" provisions.

The NGPA was enacted to remedy shortages which had developed in the interstate gas market during the 1970's. Responding to the "incentive prices" offered in the higher-priced categories of gas by the NGPA, producers drilled high-cost wells beginning in 1979. Pipeline companies entered into contracts with producers agreeing to pay the maximum lawful prices permitted by Congress,[9] and to further encourage drilling, agreed to provisions requiring the pipeline purchaser to take, or, if not taken, to pay for, high percentages of the quantities of gas which the wells were capable of producing.

The pipelines' ability to pay prices higher than the average field market price for some categories of gas was enhanced by the "vintage pricing system" under the NGPA under which widely ranging maximum lawful prices were established.[10] Pipelines "roll in" all of these varying prices in their resale rates, charging their customers rates based on the weighted average cost of gas ("WACOG") incurred by the pipelines.[11]

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[8] The Commission's Regulations, 18 C.F.R. § 154.103, require that the "make-up" term be at least five years. Many contracts permit make-up for the life of the contract.

[9] In a few instances, primarily involving very costly wells drilled below the depth of 15,000 feet, Congress removed price controls entirely on November 1, 1979. *See* 15 U.S.C. §§ 3317(c)(1)-(4), 3331(b). Price controls were removed on some other categories on January 1, 1985 and July 1, 1987. *See* 15 U.S.C. § 3331.

[10] *See*, Order of Director, Office of Pipeline and Producer Regulation, Federal Energy Regulatory Commission, issued November 1, 1987, pursuant to 18 C.F.R. § 375.307(k) (1987).

[11] *See* Columbia LNG Corp. v. FPC, 491 F.2d 651, 653-54 (5th Cir. 1974).

By 1983 the shortage of natural gas had been replaced by a surplus of gas deliverability.[12] Competitive pressures from such surplus together with pressures from alternative fuels began to drive down the price of new supplies. In some cases where the pipelines had contracted to pay specified prices without reserving the right to renegotiate if the market price went down, contract prices exceed the new market prices and the cost of alternative fuels. In recent years, the minimum purchase commitments of some pipelines have exceeded their markets and as a result some pipelines are obligated to pay for gas they have not taken.

Pipelines reacted to the abrupt shift from a shortage of gas to a surplus, and to the reduction in market demand, in various ways. Virtually all interstate pipelines ceased executing new long-term contracts with significant take-or-pay commitments. Some pipelines were able to adjust their purchasing practices to balance their gas inventory with reduced demand so that no take-or-pay obligations were incurred. Other pipelines restructured their contracts through negotiations with producers to reduce take obligations and prices, in return for cash payments.[13]

Some pipelines, on the other hand, followed the policy of refusing to take the minimum quantity of high-priced gas required by their contracts, thereby incurring substantial take-or-pay obligations, and sought relief from

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[12] The total proved reserves, however, continued to decline. *See* Energy Information Administration (Office of Oil and Gas) "Advance Summary of the U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves: 1986 Annual Report" (September 1987). This Report indicated that U.S. proved reserves as of December 31, 1986, had declined for five consecutive years, and had reached the lowest level since 1976.

[13] *E.g.*, Columbia Gas Transmission Corporation.

their contracts through Commission orders. This approach was rejected by the Commission.[14]

Although pipelines' reported take-or-pay exposures are very large, a comparison of actual payments with pipeline estimates of "exposure" shows that most of the "exposure" is never realized.[15]

The Commission has dealt with the take-or-pay problem through policy initiatives designed to encourage voluntary renegotiation of pipeline/producer contracts. By a Statement of Policy issued April 10, 1985, the Commission assured pipelines that cash payments to producers to resolve such obligations (which averaged between 10 to 20 cents on the dollar) would not violate NGPA ceiling prices, and could be flowed through to customers in pipeline rate cases, where prudently incurred.[16] While this case was pending in the court of appeals, the Commission issued a Proposed Statement of Policy on take-or-pay, dealing with the method by which such payments could be flowed through without lengthy proceedings.[17] Throughout the entire period from 1982 to the

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[14] App. 134a-135a. Tennessee Gas Pipeline Co. v. Pan-Canadian Petroleum Co., Docket No. RP83-109-000, 37 FERC (CCH) ¶ 61,236 (Dec. 10, 1986), *reh'g denied*, 38 FERC (CCH) ¶ 61,236 (Mar. 10, 1987), *remanded*, No. 87-1206 (D.C. Cir., September 15, 1987) (unreported order). Of the total outstanding take-or-pay obligations of interstate pipelines at the end of 1985 of $6.1 billion, Tennessee owed $2 billion. Tennessee owed $1.7 billion of the $6.8 billion outstanding take-or-pay obligations of all interstate pipelines at the end of 1986. Interstate Natural Gas Association of America [pipeline trade organization] Study "The Unresolved Take-Or-Pay Problem; Year-end 1986 Exposure and Costs" (July 1987) (hereinafter cited as "INGAA Study"), at note 15.

[15] Actual take-or-pay prepayments for the years 1982 through July 31, 1985, appear at App. 141a-144a.

[16] FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,637; discussed, App. 137a-138a.

[17] "Proposed Statement of Policy," Docket No. PL87-3-000, 38 FERC (CCH) ¶ 61,230 (March 5, 1987).

present the Commission has addressed in pipeline rate cases the following issues which bear on the take-or-pay problem: (i) pipeline purchasing practices, (ii) the method of flowing through (or requiring the pipeline to bear) take-or-pay prepayments or settlement costs, and (iii) the costs of settling outstanding unpaid take-or-pay obligations and restructuring high-take contracts.

In the Orders below, the Commission concluded that direct action by it to abrogate or modify contracts for the sale of gas subject to its NGA jurisdiction under its powers in Section 5 of the NGA, or indirect interference with jurisdictional and non-jurisdictional contracts through the imposition of a crediting condition on a producer's right to open-access transportation over interstate pipelines, was bad policy because it raised serious questions about "the ability of parties to rely on private contracts," [18] which were to be the basis of market-determined prices in the future. The Commission found that such actions would relieve the pipelines from the competitive pressures of the marketplace by permitting them to deny transportation to producers who were unwilling to renegotiate their contracts, even if those contracts were not involved in the transportation being sought. The Commission further found that such actions would result in inequities among groups of producers, and among consumers which sought to purchase from them, and would cause undue discrimination under Sections 4 and 5 of the NGA.[19] Finally, the Commission expressed great doubt that it had authority to deny access to producers unless they give up rights contained in contracts no longer subject to the Commission's NGA jurisdiction.[20]

The court of appeals found the Commission's explanations inadequate and unpersuasive. It engaged in its own

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[18] App. 134a-138a.

[19] App. 146a-154a.

[20] App. 135a-137a.

detailed economic analysis of the situation and strongly suggested specific policy alternatives required to be "considered" on remand by the Commission. The court of appeals remanded the case to the Commission "to determine, in light of our discussion of its questionable factual and legal premises, to what extent these policy considerations may justify its inaction on uneconomical producer-pipeline contracts. We do not require that the Commission reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking." [21] The court of appeals' mandate has been widely interpreted as a requirement for Commission action.

REASONS FOR GRANTING THE PETITION

A. The Court Of Appeals Erred In Disregarding NGPA Limits On The Commission's Power To Interfere With Producer Contracts.

In rejecting the Commission's analysis of take-or-pay issues, the court of appeals stated that the Commission should consider conditioning producer access to pipeline transportation on producer willingness to modify the so-called "problem contracts." [22] In response, the Commission immediately imposed such a condition on transportation access.[23] The court's suggestion was premised on

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[21] App. 94a. Judge Mikva would not accept Commission "inaction" on this issue, even if supported by additional explanation and reasoning. *See* dissent, App. 126a.

[22] App. 75a. The court of appeals noted that although parties refer to the problem as take-or-pay, what really is at issue is the price.

[23] Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol, Order No. 500, "Interim Rule and Statement of Policy," 52 Fed. Reg. 30,334, III FERC Stats. & Regs. (CCH) ¶ 30,671 (Aug. 7, 1987); *extension granted*, Order No. 500-A, 41 FERC (CCH) ¶ 61,013 (Oct. 14, 1987); *modified*, Order No. 500-B, 41 FERC (CCH) ¶ 61,024 (Oct. 16, 1987); Order Explaining Crediting Provisions, 41 FERC (CCH) ¶ 61,025 (Oct. 16, 1987) ("Order No. 500 series").

a reading of the Commission's authority which is at odds with the requirements of the NGPA. If uncorrected, the court's construction will lead to years of uncertainty about the consequences of transportation, unjustified denial of access to transportation for many producers, and an unjustified restriction on supplies available to consumers.

The NGPA fundamentally changed the regulatory structure of the natural gas industry, freeing producers from the cost-based price regulations which had led to serious gas shortages in the interstate market, and replacing those regulations with a series of statutory price ceilings, and with phased deregulation of the prices of most new gas supplies. The NGPA was "designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas." [24] With few exceptions, wellhead prices ultimately were to be determined by free market forces and not by regulatory fiat.

Having created this new structure, Congress was justifiably concerned that the residual Commission authority over interstate pipeline sales and transportation could be used to undermine the free market.[25] As a result, Con-

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[24] Public Service Commission v. Mid-Louisiana Gas Co., 463 U.S. 319, 331 (1983).

[25] *See, e.g.*, Office of Consumers' Counsel v. FERC, 783 F.2d 206, 221 (D.C. Cir. 1986), *motion for enforcement granted*, 826 F.2d 1136 (D.C. Cir. 1987):

> Both the statutory mandate to deregulate producer prices and the available legislative history reflect congressional concern with "back door" regulation of producers. The fear was that if it were easy for FERC to deny passthrough of the prices pipelines paid producers, this would provide an avenue for the Commission to regulate indirectly the prices producers charged.

gress included several provisions designed to insure that the Commission could not undermine the policy decisions implicit in the NGPA. First, although Congress authorized the Commission to increase certain ceiling prices,[26] it did not authorize the Commission to reduce the ceiling prices set by the NGPA or to reimpose price ceilings for deregulated gas.[27] Second, to assure that the Commission could not regulate the prices indirectly, Congress specified that all prices at or below the applicable NGPA ceiling and all unregulated prices were to be deemed "just and reasonable," [28] and that the Commission could not deny pipelines the right to recover such costs in the absence of fraud or abuse.[29] Finally, to assure that the Commission could not use its power under Section 7 of the NGA to condition access to jurisdictional transportation facilities as a tool to regulate wellhead prices,[30] Congress provided that the Commission "may not deny or condition

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[26] NGPA § 104(b)(2), 15 U.S.C. § 3314(b)(2) (1982), and NGPA § 106(c), 15 U.S.C. § 3316(c) (1982).

[27] The President was given limited authority to reimpose maximum lawful prices for deregulated gas. *See* NGPA § 122, 15 U.S.C. § 3332 (1982).

[28] NGPA § 601(b), 16 U.S.C. § 3431(b) (1982). This declaration severely restricts the Commission's authority to abrogate producer contracts remaining within its jurisdiction under its NGA Section 5 authority. The Commission's power under NGA Section 5 is predicated upon a determination that rates, charges, or other terms set forth in existing contracts are unjust and unreasonable, but the NGPA effectively bars the Commission from interdicting contracts based upon consideration of prices. Section 101(b)(9), 15 U.S.C. § 3311(b)(9) (1982).

[29] NGPA § 601(c)(2), 15 U.S.C. § 3431(c)(2) (1982).

[30] This Court had held, for example, that the Commission could condition transportation certificates to assure that the sales price did not exceed the Commission's set rates even where the Commission did not have authority to regulate directly the price being charged. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961).

the grant of any certificate" based on the amount to be paid in the sale so long as the price is one deemed "just and reasonable" under Section 601(b).[31]

The Commission, in Order No. 436, refused to violate the clear precepts of the NGPA and condition transportation access on modification of "problem contracts."[32] The court of appeals found the Commission's obedience to the limitations imposed by the NGPA to be reversible error. Ignoring the clear statutory prohibition against the Commission's interference in producer/pipeline pricing issues, the court of appeals instructed the Commission to explain more thoroughly its reluctance to interfere in the pricing and terms of contracts negotiated under circumstances that Congress declared to be outside the realm of regulatory oversight.

The court's instruction that the Commission reconsider its decision not to invoke NGA Section 5 to set aside or modify take-or-pay provisions in jurisdictional contracts, was improper.[33] The court conceded that take-or-pay clauses are "a perfectly natural allocation of risk between producer and purchaser"[34] and that even a clause that specifies one hundred percent takes is not *per se* unreasonable. The court recognized that it is only the combination of take-or-pay clauses with high contract prices which causes problems.[35] Although the court char-

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[31] NGPA § 601(c)(1), 15 U.S.C. § 3431(c)(1) (1982).

[32] App. 75a.

[33] The Commission lacks jurisdiction to modify the terms of contracts that are not subject to its jurisdiction under the NGA. Pennzoil Co. v. FERC, 645 F.2d 360, 380-83 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); App. 89a n.30. The NGPA does not provide the Commission with any independent authority to modify contract terms. Pennzoil Co. v. FERC, 645 F.2d at 374-75.

[34] App. 75a.

[35] App. 75a.

acterized the prices as "high,"[36] the NGPA requires that such prices be accepted as just and reasonable for the purpose of Section 5.[37] To set aside or modify a take-or-pay clause because the price required to be paid is deemed to be too high would be an *ultra vires* act beyond the Commission's statutory authority.[38]

The second alternative the court directed the Commission to consider on remand is conditioning producers' access to transportation as a means of solving take-or-pay issues. The court recognized that such conditioning power, if exercised, may have the effect of forcing reductions of producer prices. Indeed, that would be the purpose of the condition. The court argued, however, that while the results may be the same, access conditions are not the same as direct wellhead price controls.[39] The court's conclusion might not be at odds with the NGPA if Congress had simply prohibited the Commission from direct price controls. It is, however, irreconcilably at odds with Congress' prohibition of indirect action to interfere with the operation of the free market and of the statutory ceiling prices.

While the court of appeals was critical of the Commission's failure to condition access on modification of problem contracts, it did not discuss the authority under

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[36] App. 90a.

[37] NGPA § 601(b), 15 U.S.C. § 3431(b). The court itself acknowledged that invocation of Section 5 may be problematic insomuch as the "FERC is clearly barred from setting sub-NGPA ceilings on jurisdictional wellhead sales"; and any Section 5 action instituted without regard to price "would not reach many contracts that are deleterious only because very high price provisions combine with otherwise harmless take-or-pay clauses" and may "restrict contracts that are harmless despite high take-or-pay problems." App. 90a; *see also*, App. 79a n.26.

[38] App. 79a.

[39] App. 93a-94a.

which such conditions could be imposed.[40] As noted above, Section 601(c)(2) of the NGPA speaks directly to the Commission's conditioning authority under Section 7 of the NGA and prohibits the Commission from conditioning *any* certificate based on amounts paid, as long as the prices comply with applicable provisions of Title I of the NGPA. This restriction, in plain terms, applies to transportation certificates as well as sales certificates.[41]

While the Commission has authority to specify terms and conditions for transportation provided under Section 311,[42] that authority cannot be read to undermine the clearly expressed congressional intent to prevent any regulatory interference with the free market pricing scheme set out in the NGPA. Section 601(a)(2)(A)(ii)[43] excludes from the Commission's NGA jurisdiction transportation of gas in interstate commerce under Section 311.

Section 311 was designed to encourage integration of interstate and intrastate systems into a national supply grid by assuring the pipelines that they would not be subject to the Commission's NGA regulation. To suggest that Congress permitted the Commission to impose conditions on Section 311 transactions that are expressly prohibited with respect to Section 7 transactions is inconsistent with the structure and purpose of Section 311.

The Commission's statutory mandate is to "overse[e] a national market price regulatory scheme."[44] Contrary

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[40] Such authority cannot merely be inferred from the Commission's general statutory charge.

[41] NGPA § 601(c), 15 U.S.C. § 3431(c).

[42] NGPA § 311(a), 15 U.S.C. § 3371(a) (1982).

[43] 15 U.S.C. § 3431(a)(2)(A)(ii).

[44] Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409, 106 S.Ct. 709, 716 (1986).

to the decision of the court of appeals, the Commission is statutorily prohibited from barring producers' access to jurisdictional facilities to effect "government pressure to reduce prices." [45] It was for the very purpose of preventing government pressure to reduce prices that Section 601(c)(1) was enacted.

The court of appeals is precluded from inciting regulatory action that:

> . . . undermines Congress' determination that the supply, the demand, and the price of [deregulated] gas be determined by market forces. To the extent that Congress denied FERC the power to regulate affirmatively particular aspects of the first sale of gas, it did so because it wanted to leave determination of supply and first-sale prices to the market.[46]

The Commission in Order No. 436 carefully balanced the authorities given to it to control pipeline behavior within the strict limitations placed upon its power to interfere directly or indirectly with prices and terms of wellhead purchases. The Commission utilized its authorities in the manner contemplated by Congress, using its NGA authorities to reduce the monopoly power inherent in interstate pipeline companies that prevented customers from enjoying the fruits of competition in producing area markets. However, the Commission refused to interfere with the pipeline/producer agreements which Congress had determined should be left to the free market. The action of the court of appeals in setting aside the Commission's Order No. 436 because the Commission observed the limits of its mandates, creates and relies upon an erroneous construction of the NGPA.

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[45] App. 94a.

[46] Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. at ——, 106 S.Ct. at 716-17.

B. The Court Of Appeals Erred In Failing To Defer To The Commission's Decision On Factual And Policy Matters.

As the court of appeals recognized throughout its opinion,[47] it is the Commission, not the courts of appeals, that is charged by Congress with the primary authority and responsibility to administer the statute.[48] "The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors." [49]

The courts of appeals must defer to agency findings of facts based upon substantial evidence.[50] Often the agency cannot measure the proposed regulation's effect until after it has been implemented.[51] Consequently, rulemaking must sometimes rest on judgment and prediction that cannot be completely supported by existing data.[52] In such cases, complete evidentiary support for the Commission's ultimate conclusion is not required.[53] When examining an agency's prediction within its area of special expertise, a reviewing court must afford the greatest deference.[54]

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[47] App. 34a, 45a.

[48] Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

[49] Mobil Oil Corp. v. FPC, 417 U.S. 283, 308 (1974).

[50] NGPA § 506(a)(4), 15 U.S.C. § 3416(a)(4) (1982); NGA § 19(b), 15 U.S.C. § 717(b) (1982).

[51] Telocator Network of America v. FCC, 691 F.2d 525, 542 (D.C. Cir. 1982).

[52] *See, e.g.*, FCC v. WNCN Listeners Guild, 450 U.S. 582, 594-96 (1981); FCC v. National Citizens Committee for Broadcasting, 436 U.S. 775, 813-14 (1978).

[53] *Id.*

[54] Baltimore Gas & Electric Co. v. Natural Resources Defense Council, Inc., 462 U.S. 87, 103 (1983).

In this case, the court of appeals has imposed its view of the future and rejected the Commission's own analysis. The Commission's decision, however, reflected reasoned consideration of relevant issues.

In subtle deference to this Court's instruction, the court of appeals cast its order in the form of a requirement that the Commission provide further "explanations" or "reasoning" in support of its decision. Without such explanation, the court of appeals clearly expected the Commission to: (i) modify the quantity provisions of jurisdictional contracts under Section 5 of the NGA; or (ii) impose a condition which would require producers to cede rights under their long-term gas sales contracts in order to obtain transportation of the gas.[55] Should the Commission elect to stand firm on its position on these issues after reconsideration, it would face further review by the court of appeals on whether its further "explanation" was sufficient. The court of appeals thereby sought to coerce the Commission to adopt *its* view of these issues, instead of the Commission's *own analysis.* In the meantime, the manner in which the entire interstate pipeline industry will operate, and the manner in which the producers and consumers of natural gas will buy and sell an essential national commodity, remain in doubt.

The Commission decision not to condition producer access to transportation on granting of take-or-pay relief or taking action under Section 5 of the NGA is consistent with the purpose of the NGPA.[56] Congressional pol-

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[55] App. 89a-94a.

[56] This Court accords great deference to the interpretation given the statute by those agency officials charged with its enforcement. Udall v. Tallman, 380 U.S. 1, 16-17 (1965); Red Lion Broadcasting Company, Inc. v. FCC, 395 U.S. 367, 381 (1969); Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978). Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Insurance Co., 463 U.S. 29, 42-6 (1983). Whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, the Court

icy, as embodied in the NGPA, is to move towards a deregulated gas commodity market. Interfering with producer/pipeline contracts would introduce artificial distortions into the gas sales market and would not be consonant with congressional intent.[57]

The Commission's decision in Order No. 436 is consistent with the prohibitions of the NGA against undue discrimination. Conditioning producer access would run completely counter to the whole idea of opening up the transportation grid on a non-discriminatory basis.[58] It would be inconsistent with the non-discrimination requirement of both Order No. 436 and the NGA.[59] It would discriminate against producer/sellers and certain buyers and hinder the flow of gas from willing sellers to willing buyers.[60] The effect of the condition on access is to allow the pipeline to use its monopoly power over transportation to force the producer to modify his contracts with that pipeline.

The Commission considered the alternatives "suggested" by the court of appeals and clearly articulated its reasons for not abrogating private contracts or otherwise conditioning access to jurisdictional facilities. First, the Commission noted that the bulk of the perceived problem existed in contracts not subject to its jurisdiction.[61]

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will defer to the agency's expertise if its choice is reasonable, unless it appears from the statute or legislative history that the accommodation is not one that Congress would have sanctioned. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844-46 (1984); United States v. Shimer, 367 U.S. 374, 382-83 (1961).

[57] App. 133a-135a.

[58] App. 137a.

[59] App. 147a-148a.

[60] App. 152a.

[61] The court of appeals noted that higher-priced Outer Continental Shelf gas remains subject to the Commission's jurisdiction

The proportion of wellhead sales still subject to the NGA is steadily declining. It would be incomplete and inequitable to allow pipelines to reduce their takes only under contracts still subject to the Commission's NGA jurisdiction.[62]

Second, the Commission noted the strong public policy objections to abrogating the private contracts of natural gas producers and interstate pipelines. Private contracts are the foundation of the gas industry.[63] The Commission reasonably concluded that it should not interfere with the ability of private parties in this industry to rely on private contracts as a tool for structuring basic economic relationships.[64]

Third, the Commission reasonably concluded that the pipelines could and would renegotiate their "problem" contracts with producers without governmental interference. The Commission found that an adequate regulatory climate existed under which pipelines may work with producers to deal with their take-or-pay contracts.[65] The Commission also concluded that the April 10, 1987 policy statement and procedure for granting expedited producer abandonments will assist settlement of outstanding take-or-pay and deter accrual of take-or-pay.[66]

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under Section 102 of the NGPA, 15 U.S.C. 3312 (1982). However, only new natural gas from "old" Outer Continental Shelf leases remains under Commission jurisdiction under Section 102(d). Natural gas produced from new Outer Continental Shelf leases under Section 102(c) has been removed from Commission jurisdiction pursuant to Section 601(a)(1)(B)(ii), 15 U.S.C. § 3431(a)(1)(B)(ii).

[62] App. 153a-154a.

[63] Even the court of appeals recognized "[u]nilateral abrogation of a contract is an extreme measure." App. 66a. *See, also,* United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956).

[64] App. 134a.

[65] App. 151a-152a.

[66] App. 150a-151a.

The Commission determined that pipelines continued to make progress in renegotiating their contracts with producers.[67] Prepayments were declining and accrued take-or-pay liability is being reduced.[68] Pipelines had ample bargaining power with producers to renegotiate their take-or-pay contracts.

Initial implementation of Order No. 436 has yielded empirical data demonstrating the soundness of the Commission's predictions. Pipelines and producers have settled all but ten to fifteen percent of take-or-pay accruals. Negotiated contract restructuring that provides for market responsive pricing and reduced take requirements will reduce future accruals. The pipeline trade association forecasts the take-or-pay liability accruing in 1987 to be down 20 percent from take-or-pay liability accrued in 1986.[69] Producers have filed for permanent abandonment of substantial volumes of jurisdictional gas that would reduce deliverability committed to the pipelines and hence take-or-pay requirements.

Market pressures are forcing restructuring of these contracts at a rapid rate, with producers waiving their contract rights for compensation amounting to 10 to 20 cents on the dollar.[70] In 1985 and 1986 pipelines paid a total of $700 million for contract reformation, to reduce or eliminate future take-or-pay obligations under the contracts affected.[71]

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[67] App. 136a-137a, 149a.

[68] App. 136a-137a, 149a.

[69] *See*, INGAA Study, *supra* note 14.

[70] App. 141a-144a; U.S. Department of Energy "Increasing Competition in the Natural Gas Market; Second Report Required by Section 123 of the Natural Gas Policy Act" (January 1985), 5-4 to 5-8; INGAA Study, *supra* note 14, at 5-7.

[71] INGAA Study, *supra*, Table 4, p. 9.

Massive quantities of gas have been released from producer/pipeline contracts, which are then cancelled, or the released gas is credited against the contract obligations when resold by the producer to new buyers at reduced prices. Even the court of appeals noted: "FERC policy arguments in favor of subjecting pipelines to the pressures of a competitive market seem powerful and well grounded in the statutes it is authorized to enforce." [72]

The Commission predicted that the market would solve the "problem" and indeed, market pressures are forcing restructuring of these contracts at a rapid rate. In essence the court of appeals rejected the Commission's conclusions, calling the Commission's economic projections "utterly Panglossian." [73] The underlying basis of the court's opinion is the conclusion that "market forces" will fail, or will be prevented from operating, and therefore some form of judicial/administrative solution is required. By substituting its judgment for that of the Commission, the court of appeals erred.

C. The Commission Has Discretion To Select The Proceeding In Which It Addresses Discretionary Issues.

Whether the Commission is required to deal with the take-or-pay problem *in this proceeding*, or whether it may deal with the problem in individual pipeline rate cases and rulemaking proceedings to allocate the cost of reforming uneconomic pipeline/producer contracts between pipelines and their customers, is an issue which the court of appeals decided against the Commission, without discussion or supportive reasoning.

This Court has spoken directly on the Commission's power to resolve pipeline take-or-pay problems in pipeline rate cases, rather than in direct action against the pro-

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[72] App. 88a.

[73] App. 94a.

ducers. In *FPC v. Sunray DX Oil Co.*,[74] the Commission had refused to take into account pipelines' take-or-pay problems in producer proceedings. The District of Columbia Circuit, the same Court that remanded Order No. 436, found that the Commission erred in declining to come to grips with the issue in producer certificate proceedings. This Court disagreed, finding that pipeline take-or-pay problems could properly be considered in pipeline rate proceedings.[75] This is precisely what the Commission seeks to do here, and which the court of appeals found to be inadequate.

Ample authority supports the power and discretion of an administrative agency to select the forum in which issues are addressed.[76]

The court of appeals' opinion seeks to lead the Commission into the position of reinstating the pipelines' monopoly power to deny a producer or his customer transportation of gas unless and until the producer is ready to waive provisions in long-term gas sales contracts in which the pipeline assumed the risk of market demand.[77]

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[74] 391 U.S. 9 (1968).

[75] 391 U.S. at 49-52. In the rulemaking (Order No. 334, 37 F.P.C. 110 (1967)) referred to by the Court in *Sunray*, 391 U.S. at 50 n.51, the Commission declined to abrogate take-or-pay provisions under its Section 5 authority. The Commission's judgment was vindicated by subsequent events. The growing gas shortage in the 1970's allowed take-or-pay balances to be "made-up" by pipelines without losses. Many authorities believe similar results will occur in the gas market in the next few years.

[76] *See* SEC v. Chenery Corp., 332 U.S. 194, 201-04 (1947); NLRB v. Bell Aerospace Co., 416 U.S. 267, 294 (1974); NAACP v. FPC, 425 U.S. 662, 668-69 (1976); Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 531-35, 543, 546 (1978); FPC v. Transcontinental Gas Pipe Line Corp., 423 U.S. 326 (1976); FCC v. Schreiber, 381 U.S. 279, 290 (1965); Fort Pierce Utility Authority v. FPC, 526 F.2d 993, 995, 998-99 (5th Cir. 1976).

[77] Universal Resources Corp. v. Panhandle Eastern Pipe Line Co., 813 F.2d 77, 80 (5th Cir. 1987).

In so doing, the Court of Appeals substituted its judgment for that of the Commission, in violation of the standards of review laid down by this Court.[78]

CONCLUSION

The Writ should be granted.

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[78] Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974); Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

APPENDICES TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT AND LIST OF PARENT COMPANIES, SUBSIDIARIES, AND AFFILIATES REQUIRED BY RULE 28.1

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

AIR PRODUCTS AND CHEMICALS, INC., et al.,
ALGONQUIN GAS TRANSMISSION COMPANY,
ALABAMA-TENNESSEE NATURAL GAS COMPANY,
AMERICAN BAKERS ASSOCIATION,
AMERICAN GAS ASSOCIATION,
AMERICAN PUBLIC GAS ASSOCIATION,
AMERICAN PAPER INSTITUTE, INC.,
ARKLA, INC.,
AMOCO PRODUCTION COMPANY,
ARCO OIL AND GAS COMPANY,
ASHLAND EXPLORATION, INC.,
ARMSTRONG WORLD INDUSTRIES,
ASSOCIATED GAS DISTRIBUTORS,
ASSOCIATION OF TEXAS INTRASTATE
NATURAL GAS PIPELINES,
ATLANTA GAS LIGHT COMPANY,
BALTIMORE GAS AND ELECTRIC COMPANY,
BROOKLYN UNION GAS COMPANY,
CABOT CORPORATION,
CAROLINA UTILITY CUSTOMERS ASSOCIATION, INC.,
CASCADE NATURAL GAS CORPORATION,
CENTRAL ILLINOIS LIGHT COMPANY,

CHAMPLIN PETROLEUM COMPANY,
CHEMICAL MANUFACTURERS ASSOCIATION,
CHEVRON U.S.A. INC.,
CITIES SERVICE OIL AND GAS CORPORATION,
CITIZENS ENERGY CORPORATION,
CITY OF WILCOX, ARIZONA and ARIZONA ELECTRIC POWER COOPERATIVE, INC.,
COLUMBIA GAS DISTRIBUTION COMPANIES,
COLUMBIA GAS TRANSMISSION CORPORATION,
COLUMBIA NITROGEN CORPORATION and NIPRO, INC.,
COMMONWEALTH OF KENTUCKY PUBLIC SERVICE COMMISSION,
CONOCO, INC.,
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
CONSUMERS POWER COMPANY AND MICHIGAN GAS STORAGE COMPANY,
DELHI GAS PIPELINE CORPORATION,
DEPARTMENT OF PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
DIAMOND SHAMROCK EXPLORATION COMPANY,
EL PASO NATURAL GAS COMPANY,
ENTEX, INC.,
EXXON CORPORATION
FERTILIZER INSTITUTE,
FLORIDA GAS TRANSMISSION COMPANY,
FOOTHILLS PIPE LINES (YUKON) LTD.,
GAS DISTRIBUTORS INFORMATION SERVICE,
STATE OF LOUISIANA,
TENNECO OIL COMPANY,
TENNGASCO CORPORATION,
TEXAS EASTERN TRANSMISSION CORPORATION,
TEXACO, INC.,
TEXAS GAS EXPLORATION CORPORATION,
TEXAS GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPELINE CORPORATION,
TRANSOK, INC.,
TRANSWESTERN PIPELINE COMPANY,
TRUNKLINE GAS COMPANY,

WEIRTON STEEL CORPORATION,
WESTCOAST TRANSMISSION COMPANY LIMITED,
WEST VIRGINIA CONSUMER ADVOCATE,
WISCONSIN POWER & LIGHT COMPANY,
UNION OIL COMPANY OF CALIFORNIA,
VALERO TRANSMISSION COMPANY,
UNITED DISTRIBUTION COMPANIES,
UGI CORPORATION,
KANSAS POWER AND LIGHT COMPANY,
STATE OF MICHIGAN AND MICHIGAN PUBLIC SERVICE COMMISSION,
SOUTH JERSEY GAS COMPANY,
WASHINGTON GAS LIGHT COMPANY,
ARIZONA PUBLIC SERVICE COMPANY,
SUN EXPLORATION AND PRODUCTION COMPANY,
BETHLEHEM STEEL CORPORATION,
Intervenors

AND CONSOLIDATED CASE NOS. 85-1812, 85-1813, 85-1818, 85-1821, 85-1830, 85-1836, 85-1001, 86-1006, 86-1007, 86-1008, 86-1016, 86-1017, 86-1018, 86-1019, 86-1020, 86-1022, 86-1023, 86-1024, 86-1029, 86-1030, 86-1031, 86-1032, 86-1034, 86-1035, 86-1036, 86-1038, 86-1042, 86-1046, 86-1047, 86-1048, 86-1049, 86-1050, 86-1051, 86-1053, 86-1054, 86-1055, 86-1056, 86-1063, 86-1066, 86-1067, 86-1076, 86-1081, 86-1083, 86-1085, 86-1086, 86-1087, 86-1088, 86-1089, 86-1090, 86-1092, 86-1094, 86-1095, 86-1097, 86-1098, 86-1099, 86-1100, 86-1102, 86-1103, 86-1153, 86-1154, 86-1155, 86-1226, 86-1235, and 86-1246

Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Argued October 14 and 15, 1986

Decided June 23, 1987

William W. Brackett, with whom *David F. Collins* and *G. Mark Cook* were on the brief for ANR Pipeline Co., et al., petitioners in Nos. 86-1055 and 86-1067. *Terry O. Vogel*, *Jeffrey M. Goldsmith*, and *William M. Lange* entered appearances.

Roberta L. Halladay, with whom *Jerome C. Muys* and *C. William Cooper* for United Distribution Companies, petitioners in No. 86-1006 and intervenors in Nos. 86-1811, 86-1016, 86-1067, 86-1087, and 86-1153; *William Warfield Ross* and *Daniel Koffsky* for Consumers Power Co., petitioner in No. 86-1047 and intervenor in No. 85-1811, and *Thomas Patrick* and *Karen Cargill* for The Peoples Gas Light and Coke Co. and North Shore Gas Co., petitioners in No. 86-1155 and intervenors in Nos. 85-1811 and 86-1153, were on the joint brief. *Janet M. Robins* for Consumer Power Co., et al. and *Mark McGuire* for The Peoples Gas Light and Coke Co., et al. also entered appearances.

John T. Miller, Jr. for Elizabethtown Gas Co., petitioner in No. 85-1836.

Robert A. Nelson, Jr. for Northwest Gas Co., with whom *Donald K. Darkner* and *Daniel F. Stenger* for CP National Corp. and *Thomas F. Brosnan* for Washington Natural Gas Co. were on the joint brief for petitioners in No. 86-1097.

Kenneth J. Nieses for Laclede Gas Co., petitioner in No. 86-1001 and intervenor in No. 85-1811.

David B. Robinson, with whom *William J. Guste, Jr.*, Attorney General, State of Louisiana, and *Theodore L. Jones* for State of Louisiana, petitioners in No. 86-1053 and 86-1051 and intervenor in No. 85-1811; *Patrick J. Nugent*, *James M. Costan*, and *Elisa J. Grammer* for Association of Texas Intrastate Natural Gas Pipelines, intervenor in No. 85-1811; *J. Paul Douglas*, with whom

Brian J. Heisler and *Kevin Sweeney* for Amoco Gas Co., petitioner in Nos. 86-1081 and 86-1154 and intervenor in Nos. 85-1811, 86-1016, and 86-1055; *C. Burnett Dunn* for Oklahoma Natural Gas Co., intervenor in Nos. 85-1811, 86-1067, 86-1088, and 86-1153; and *William I. Harkaway* for Consolidated Edison of NY, Inc., petitioner in No. 86-1094 and intervenor in No. 85-1811, were on the joint brief. *Timothy Keegan* for Association of Texas Intrastate Natural Gas Pipelines, *Diane Siler* for the State of Louisiana, and *Barbara M. Gunther* and *Steven I. Kalish* for Consolidated Edison of NY, Inc. also entered appearances.

Edward J. Grenier, Jr., with whom *William H. Penniman, Glen S. Howard, Gail S. Gilman, James P. Rathvon*, and *James M. Bushee* for the Process Gas Consumers Group and the American Iron & Steel Institute, petitioners in Nos. 86-1007 and 86-1008 and intervenors in Nos. 85-1811, 86-1226, 86-1235, and 86-1246; *Nicholas W. Fels* and *David N. Heaps* for Air Products & Chemicals, Inc., et al., intervenor in Nos. 85-1811, 86-1016, and 86-1017; *Stephen A. Herman* and *John G. Froemming* for the Fertilizer Institute and American Bakers Association, intervenors in Nos. 85-1811, 86-1016, and 86-1017; *Rigdon H. Boykin* and *Thomas E. Hirsch, III* for American Paper Institute, petitioner in No. 86-1089 and intervenor in Nos. 85-1811, 86-1016, and 86-1017; and *John W. Hardwicke* for Maryland Industrial Group, intervenor in Nos. 85-1811, 86-1016, and 86-1017 were on the joint brief.

Thomas G. Johnson, with whom *M.G. Brookshier* and *Charles McClees, Jr.*, for Shell Offshore, Inc. and Shell Western Electric and Power Inc., petitioner in Nos. 86-1016, 86-1017, and 86-1018 and intervenor in Nos. 85-1811, 85-1812, and 85-1813; *Harris S. Wood* and *Michael G. Maloney* for Arco Oil & Gas Co., intervenor in Nos. 85-1811, 85-1087, and 86-1153; *Thomas J. Eastment* and *Charles M. Darling IV* for Ashland Corp., petitioner in No. 86-1092 and intervenor in No. 85-1811; *Roscoe C. Elmore* for Cabot Corp., intervenor in No.

85-1811; *James B. Atkin, Norma J. Rosner,* and *David J. Evans* for Chevron U.S.A., Inc., petitioner in No. 85-1050 and intervenor in No. 85-1811; *Michael L. Pate* for Cities Service Oil and Gas Corp., intervenor in No. 85-1811; *Ernest J. Altgelt, III* for Conoco, Inc., intervenor in Nos. 85-1811 and 86-1016; *Edmunds Travis, Jr., Glenn H. Mapes, Jr.,* and *Douglas W. Rasch* for Exxon Corp., petitioner in No. 86-1029 and intervenor in No. 85-1811; *John J. Atkins* for Kerr-McGee Corp., petitioner in No. 86-1083; *Gary M. Prescott* for Marathon Oil Co., intervenor in No. 85-1811; *Robert D. Haworth, Jay G. Martin,* and *Thomas George Wagner* for Mobil Oil Corp., et al., intervenors in Nos. 85-1811, 86-1016, 86-1067, 86-1087, 86-1088, and 86-1153; *John B. Chapman, John K. McDonald, Charles E. Suffling,* and *Mary Lee Pieper* for Pennzoil Co., et al., petitioners in Nos. 86-1016 and 86-1103 and intervenors in Nos. 85-1811, 85-1812, 85-1813, and 85-1818; *John L. Williford, Larry Pain,* and *Jennifer A. Cates* for Phillips Petroleum Co., et al., petitioners in No. 86-1087 and intervenors in Nos. 85-1811, 86-1016, 86-1055, and 86-1087; *Ronald D. Hurst* and *Paul W. Hicks* for Placid Oil Co., intervenor in No. 85-1811; *JoAnn P. Russell* for Sohio Petroleum Co., intervenor in No. 85-1811; *Glen E. Taylor, Phillis Rainey,* and *F. Nan Wagoner* for Tenneco Oil Co., petitioner in No. 86-1046 and intervenor in No. 85-1811; *Karen A. Berndt, Ralph J. Pearson, Jr.,* and *David Lindberg* for Texaco, Inc., petitioner in No. 86-1088 and intervenor in No. 85-1811; *B. James McGraw* and *James M. Appelt* for Texas Gas Exploration Corp., intervenor in No. 85-1811; and *Lois Ellen Gold* for Union Oil Co., intervenor in Nos. 85-1811 and 86-1016, were on the joint brief. *Stephen L. Teichler* for Ashland Exploration, Inc., *Paul M. Young* for Cities Service Oil & Gas Corp., *William G. Robb* for Conoco, Inc., *Steven R. Severy* for Marathon Oil Co., *John M. Young* for Pennzoil Co., et al., *Nancy J. Shancke* for Sohio Petroleum Corp., *Albert Sylvia III* for Union Oil Co., of California, and *Joseph G. Stiles* for Exxon Corp. also entered appearances.

Carmen Leyato, with whom *Paul J. Kalota*, *Lynn A. Monk*, and *Thomas C. Gorak* were on the brief for Maryland People's Counsel, petitioner in Nos. 85-1813 and 86-1246 and intervenor in Nos. 85-1811, 85-1830, and 86-1016.

Harold L. Talisman with whom *Jeffrey D. Komarow* for Tennessee Gas Pipeline Co., petitioner in No. 85-1821; *Arnold D. Berkeley* and *Richard L. Chaifetz* for the City of Willcox, Arizona and Arizona Electric Power Cooperative, Inc., petitioner in Nos. 86-1016, 86-1099, and 85-1102 and intervenor in Nos. 85-1811, 86-1087, 86-1153, and 86-1226; *Jack H. Cheatman* for Interstate Natural Gas Association of America, petitioner in No. 85-1818 and intervenor in Nos. 85-1811 and 86-1153; *Paul Mallory* for National Gas Pipe Line Company of America, petitioner in No. 86-1153 and intervenor in Nos. 85-1811, 86-1016, 86-1019, 86-1020, 86-1055, and 86-1226; *Raymond N. Shibley* and *Patrick J. Whittle* for Panhandle Eastern Pipeline Corp. and Trunkline Gas Co., petitioners in Nos. 86-1035 and 86-1036 and intervenors in No. 85-1811; *John F. Harrington* for Texas Gas Transmission Corp., petitioner in No. 86-1051 and intervenor in Nos. 85-1811 and 86-1153; *Thomas F. Ryan, Jr.* for Transcontinental Gas Pipeline Corp., petitioner in No. 85-1812 and intervenor in Nos. 85-1811, 86-1019, and 86-1020; and *Richard P. Bonnifield* for Northwest Pipeline Corp., intervenor in No. 86-1032, were on the joint brief. *Michael R. Waller*, *Terence J. Collins*, and *Kathleen T. Puckitty* for Tennessee Gas Pipeline Co.; *Paul E. Goldstein*, *Roy Robertson*, and *Emmitt House* for Natural Gas Pipeline Co. of America; *John B. Rudolph*, *Carol M. Lane*, and *Stephen K. Schroeder* for Northwest Pipeline Corp.; and *William A. Williams* for Texas Gas Transmission Corp., *Robert G. Hardy*, and *Michael J. Fremuth* also entered appearances.

Richard A. Solomon, with whom *David D'Alessandro* and *David E. Blabey* for Public Service of the State of New York, petitioner in No. 85-1830 and intervenor in

Nos. 85-1811, 86-1088, and 86-1153; *Frederick Moring*, *Herbert J. Martin*, and *M. Lisanne Crowley* for Associated Gas Distributors, petitioner in No. 85-1811 and intervenor in Nos. 85-1812, 85-1813, 85-1818, 86-1016, 86-1067, 86-1087, and 86-1088; and *Janice E. Kerr, Jr.*, *Calvin Simpson*, and *Michael B. Day* for Public Utilities Commission of the State of California, petitioner in No. 6-1022 and intervenor in Nos. 85-1811 and 86-1087, were on the joint brief.

William T. Miller and *Susan N. Kelly* were on the brief for American Public Gas Association, petitioner in No. 86-1042 and intervenor in Nos. 85-1811, 86-1067, and 86-1087. *Kathleen A. McKee* also entered an appearance.

John E. Holtzinger, Jr., *John T. Stough, Jr.*, and *Jacolyn A. Simmons* were on the brief for Atlanta Gas Light Co., petitioner in Nos. 86-1049 and 86-1226 and intervenor in No. 85-1811.

Richard M. Merriman and *John R. Schaefgen, Jr.* were on the brief for Central Illinois Light Co., et al., petitioners in No. 86-1095 and intervenors in No. 85-1811. *Stephen L. Huntoon* also entered an appearance.

George H. Lawrence, *David J. Muchow*, and *Carol A. Smoots* were on the brief for American Gas Association, petitioner in No. 86-1090 and intervenor in No. 85-1811.

Jeffrey M. Petrash, *James Holt*, *David P. Van Note*, and *Daniel L. Schiffer* were on the brief for Michigan Consolidated Gas Co., petitioner in No. 86-1085 and intervenor in No. 85-1811.

Stephen J. Small and *Ronald N. Carroll* were on the brief for Columbia Gas Transmission Corp., petitioner in No. 86-1023 and intervenor in Nos. 85-1811 and 86-1153. *Richard L. Gottlieb* also entered an appearance.

Judy M. Johnson, *Platt W. Davis*, *David T. Andril*, *Bolivar C. Andrews*, and *Carl W. Ulrich* were on the brief for Texas Eastern Transmission Corp., petitioner in Nos. 86-1019, 86-1020, and 86-1235 and intervenor in

Nos. 85-1811, 86-1067, 86-1087, 86-1088, and 86-1153. *James M. McCartney* and *J. Evans Attwell* also entered appearances.

Daniel W. McGill, Paul K. Brooks, and *George A. Porch* were on the brief for Southern Indiana Gas and Electric Co., petitioner in No. 86-1098 and intervenor in Nos. 85-1811 and 86-1153. *Ronald E. Christian* and *Thomas C. Tokos* also entered appearances.

Glenn W. Letham and *Kenneth M. Albert* entered appearances for Memphis Light, Gas and Water Division, petitioner in No. 86-1024 and intervenor in No. 85-1811.

Christopher K. Sandberg entered an appearance for Minnesota Public Utilities Commission, et al., petitioners in No. 86-1030 and intervenors in No. 85-1811.

Charles D. Gray entered an appearance for National Association of Regulatory Utility Commissioners, petitioner in No. 86-1031.

Dale A. Wright and *James T. McManus* entered an appearance for Northwest Central Pipeline Corp., petitioner in No. 86-1034.

Rush Moddy, Jr., William J. Grealis, Jeffrey G. DiSciullo, Donald J. MacIver, and *Richard C. Green,* entered appearances for El Paso Natural Gas Co., petitioner in No. 86-1038 and intervenor in Nos. 85-1811, 86-1067, 86-1088, and 86-1153.

William A. Major, Jr., Donna J. Bailey, and *James J. Flood, Jr.* entered appearances for Southern Natural Gas Co., petitioner in No. 86-1048.

Byron A. Thomas and *Robert W. Baker* entered appearances for Louisiana Intrastate Gas Corp., petitioner in No. 86-1054 and intervenor in Nos. 85-1811 and 86-1153.

Phillip D. Endom entered an appearance for United Gas Pipe Line Co., petitioner in No. 86-1056.

James G. Beste entered an appearance for Monterey Pipeline Co., petitioner in No. 86-1063.

George J. Meiburger, Frank X. Kelly, and *Steve Stojic* entered appearances for Northern Natural Gas Co., petitioner in No. 86-1066.

Thomas D. Clarke and *David L. Hubard* for Southern California Gas Co., petitioner in No. 86-1076.

Howard V. Golub, Steven F. Greenwald, and *Patrick G. Golden* entered appearances for Pacific Gas and Electric Co., petitioner in No. 86-1086 and intervenor in No. 86-1153.

Mark G. Magnuson also entered an appearance for Consolidated Gas Transmission Corp., petitioner in No. 86-1100 and intervenor in Nos. 85-1811, 86-1067, and 86-1088.

Andrea Wolfman, Attorney and *Philip M. Marston,* Special Advisor, Federal Energy Regulatory Commission, with whom *Jerome M. Feit,* Solicitor and *John N. Estes III,* Attorney, Federal Energy Regulatory Commission, were on the brief for respondent.

Jennifer M. Waters, Robert B. Cooper, and *Robert Fleischman* entered appearances for intervenor Baltimore Gas and Electric Co. in Nos. 85-1811, 85-1812, 85-1813, 85-1818, 86-1016, 86-1055, 86-1067, and 85-1153.

Michael J. Manning, Patrick J. Keeley, and *James F. Moriarty* entered appearances for intervenor, Extex, Inc. in Nos. 85-1836, 86-1001, 86-1006, 85-1007, 86-1016, 86-1055, and 86-1153.

Joel L. Greene and *Barbara S. Jost* were on the brief for Arizona Public Service Co., Phelp Dodge Corp., Salt River Project Agricultural Improvment, and Power District and Gas Distributors Information Service, intervenors in Nos. 85-1811, 86-1067, and 86-1153. *Robert J. Haggerty, Tamara Huddleston, Herbert L. Zinn,* and *Richard H. Silverman* entered appearances.

John L. Shailer was on the brief for Columbia Gas Transmission Corp., intervenor in No. 85-1811. *Roger C. Post* entered an appearance.

John T. Ketcham and *Joseph O. Fryxell* entered appearances for intervenors Algonquin Gas Transmission Co. and Cascade Natural Gas Corp. in No. 85-1811.

Stanley M. Morley, Joel Zippand, and *Paul W. Diehl* entered appearances for Alabama-Tennessee Natural Gas Co., Producer's Gas Co., et al., and South Carolina Pipeline Corp., intervenors in No. 85-1811.

Cecil W. Talley entered an appearance for Arkla, Inc., intervenor in Nos. 85-1811, 86-1067, 86-1087, and 86-1153.

Michael W. Hall entered an appearance for Brooklyn Union Gas Co., intervenor in No. 85-1811.

Keith R. McCrea and *James L. Trump* entered appearances for Carolina Utility Customers Association, intervenor in No. 85-1811.

Bernard A. Foster III entered an appearance for Champlin Petroleum Co., intervenor in No. 85-1811.

David F. Zoll entered an appearance for Chemical Manufacturers Association, intervenor in No. 85-1811.

Jeffrey T. Sprung entered an appearance for Citizens Enegry Corp in No. 85-1811.

Frederic G. Berner, Jr., Michael J. McDonald, and *James L. Clegg* entered appearances for Columbia Nitrogen Corp., intervenor in No. 85-1811.

Stephen R. Melton entered an appearance for Delhi Gas Pipeline Corp., intervenor in No. 85-1811.

William V. Allison entered an appearance for Florida Gas Transmission Co., intervenor in No. 85-1811.

George W. McHenry, Jr. and *John H. Burnes, Jr.* entered appearances for intervenors Foothills Pipe Lines

and Westcoast Thansmission Company Limited, intervenors in Nos. 85-1811, 86-1067, 86-1087, 86-1088, and 86-1153.

Donald C. Shelper entered an appearance for K.N. Energy, Inc., intervenor in No. 85-1811.

Robert C. Platt entered an appearance for MESA Operating Limited Partnership and Panhandle Producers and Royalty Owners Association, intervenors in No. 85-1811.

David I. Bloom and *Wendell H. Adair, Jr.* entered appearances for Northern Illinois Gas Co., intervenor in Nos. 85-1811, 86-1153, and 86-1087.

M. Howard Petricoff entered an appearance for Ohio Oil and Gas Association, intervenor in Nos. 85-1811, 86-1016, and 86-1017.

J. Michael Reidenbach and *Joseph S. Englert, Jr.* entered appearances for Pacific Gas Transmission Co., intervenor in No. 85-1811.

John R. Staffier and *John H. Burnes, Jr.* entered appearances for Pan-Alberta Gas, Ltd., intervenor in Nos. 85-1811, 86-1067, 86-1087, 86-1088, and 86-1153.

Robert A. McDonnell entered an appearance for Philadelphia Electric Co., intervenor in Nos. 85-1811 and 86-1088.

Jerry W. Amos entered an appearance for Piedmont Natural Gas Co., intervenor in No. 85-1811.

James R. Lacey and *Shawn P. Leyder* entered appearances for Public Service Electric and Gas Co., intervenor in Nos. 85-1811, 86-1226, 86-1235, and 86-1246.

Michael D. Gayda entered an appearance for Southern California Gas Co., intervenor in Nos. 85-1811 and 86-1153.

R. David Hendrickson and *Donna J. Bailey* entered appearances for Southern Natural Gas Co., intervenor in No. 85-1811.

Brian J. Moline and *Dana L. Gorman* entered appearances for State Corporation Commission of the State of Kansas, intervenor in No. 85-1811.

Robert W. Baker entered an appearance for Tenngasco Corp., intervenor in Nos. 85-1811 and 86-1153.

Ralph Simon, Jr. entered an appearance for Transok, Inc., intervenor in No. 85-1811.

Joseph C. Bell entered an appearance for Citizen Energy Corp., intervenor in Nos. 86-1067, 86-1088, and 86-1153.

Sherrie N. Rutherford entered an appearance for Transwestern Pipeline Co., intervenor in No. 85-1811.

Frank H. Strickler and *Gordon M. Grant* entered appearances for Washington Gas Light Co., intervenor in No. 85-1811.

Richard A. Oliver and *Mary Ann Oliver* entered appearances for Weirton Steel Corp. and Bethlehem Steel Corp., intervenors in No. 85-1811.

Denise C. Goulet entered an appearance for West Virginia Consumer Advocate, intervenor in No. 85-1811.

Bruce F. Kiely and *Catherine G. Wakelyn* entered appearances for Wisconsin Power & Light Co., intervenor in No. 85-1811.

M. Frazier King, Jr. and *Thomas George Wagner* entered appearances for Valero Transmission Co., intervenor in No. 85-1811.

Frank P. Saponaro, Jr. and *Jennifer K. Walter* entered appearances for UGI Corp., intervenor in No. 85-1811.

Henry J. Boyton, Assistant Attorney General, State of Michigan, *Louis J. Caruso*, *Don L. Kiskey*, *Ronald D. Eastman*, and *Lynda S. Mounts* entered appearances for State of Michigan and Michigan Public Service Commission, intervenors in No. 85-1811.

Joseph M. Oliver entered an appearance for South Jersey Co., intervenor in No. 85-1811.

David L. Konick entered an appearance for Brooklyn Union Gas Co., intervenor in No. 86-1067 and 86-1087.

John F. Povilaitis and *Charles F. Hoffman* entered appearances for Pennsylvania Public Utility Commission, intervenor in Nos. 86-1087 and 86-1153.

William B. Gundling, *Simon Lazarus*, and *Clement R. Gagne III* entered appearances for State of Connecticut and Northern Valley Environmental Council, *amici curiae* in No. 85-1811.

Before: MIKVA, BORK, and WILLIAMS, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* WILLIAMS.

Opinion concurring in the judgment in part and dissenting in part filed by *Circuit Judge* MIKVA.

WILLIAMS, *Circuit Judge*:

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I. INTRODUCTION

On October 9, 1985 the Federal Energy Regulatory Commission ("FERC"[1]) issued Order No. 436, 50 Fed. Reg. 42,408 (1985) (codified at scattered sections of 18 C.F.R.). The Order envisages a complete restructuring of the natural gas industry. It may well come to rank with the three great regulatory milestones of the industry: the passage of the Natural Gas Act, 15 U.S.C. §§ 717 *et seq.* (1982) ("NGA") in 1938, the imposition of price controls on independent producers' wellhead sales under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), and adoption of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* (1982) in 1978.

At stake is the role of interstate natural gas pipelines. Although they are obviously transporters of gas, they have until recently operated primarily as gas merchants. They buy gas from producers at the wellhead and resell it, mainly to local distribution companies ("LDCs") but also to relatively large end users. The Commission has concluded that a prevailing pipeline practice—particularly their general refusal to transport gas for third parties where to do so would displace their own sales (Joint Appendix ("J.A.") 318-19)—has caused serious market distortions. It has found this practice "unduly discriminatory" within the meaning of § 5 of the NGA. Order No. 436 is its response.

The essence of Order No. 436 is a tendency, in the industry metaphor, to "unbundle" the pipelines' transportation and merchant roles. If it is effective, the pipelines will transport the gas with which their own sales

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[1] References to the Commission also include its predecessor, the Federal Power Commission, where appropriate. *See* Executive Order No. 12,009, 42 Fed. Reg. 46,267 (1977) (implementing portions of Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977), terminating the FPC and transferring its duties to FERC, an independent agency within the Department of Energy).

compete; competition from other gas sellers (producers or traders) will give consumers the benefits of a competitive wellhead market.

Virtually every sector of the natural gas industry has challenged the Order, asserting a dazzling array of errors and omissions. They have filed some 85 briefs totaling about 2,000 pages. Oral argument spanned two days in a well-filled courtroom.[2] We here uphold most elements of the Order, but remand the case to the Commission on certain issues.

A. *Parties.*

The bulk of the petitions for review are filed by representatives of the main actors in the industry: (1) producers, (2) pipelines, (3) LDCs and (4) end users. A word follows as to the varieties and regulatory status of each, and as to the developments underlying the Commission's decision.

Producers are primarily independents, in the sense of being unaffiliated with any pipeline. Pipelines and pipeline affiliates produce only about 11% of the gas sold by pipelines in the interstate market. Interstate Natural Gas Ass'n of America, "The Gas Contracts Problem: Results of an INGAA Survey" 13 (Policy Analysis 83P-1, May 1983) (cited at J.A. 301 n.34; data for 1982). The producers typically operate under oil-and-gas leases with owners of the land or mineral interests, subject to a duty to pay royalty and at some risk of losing their leases if production ceases.

Producers' interstate wellhead sales have, through the operation of law or economics, achieved virtually complete

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[2] A lawyer in the natural gas industry once urged that the only beneficiaries of the *Phillips* decision were lawyers. *See* C. Hawkins, *The Field Price Regulation of Natural Gas* 205 (1969). The fallout from that decision appeals still to provide a rich lode.

release from binding price controls. The NPGA provided this almost immediately for certain categories of "high cost" gas. NGPA § 121(b), 15 U.S.C. § 3331(b) (1982). For most "new" gas, the NGPA established new ceilings, higher than those previously set by the Commission, and provided for gradual increases until scheduled deregulation on January 1, 1985 or July 1, 1987. NGPA §§ 102, 103, 121(a) & (c), 15 U.S.C. §§ 3312, 3313, 3331(a) & (c) (1982). In fact, current market prices at the wellhead are significantly below the ceilings remaining in these categories. *Compare Selected National Average Natural Gas Prices,* Natural Gas Monthly 10 (Jan. 1987) (average price at wellhead for March 1986 $2.16) *with Natural Gas Ceiling Prices by Category of Gas, Type of Sale, or Contract,* Natural Gas Monthly 30 (Jan. 1987) (ceiling price for § 102 and § 103 gas for same period ranged from $3.083 to $4.216). The NGPA made no provision for deregulation of "old" interstate gas, but, besides allowing escalation to reflect general price inflation, authorized the Commission to raise the former ceilings to higher "just and reasonable" levels. (The Commission actually exercised this authority on June 6, 1986, in Order No. 451, III FERC Status & Regulations ¶ 30,701, at 30,197 (1986).)

The pipelines are either intrastate or interstate. Since enactment of the NGA, the interstate pipelines have been subject to pervasive Commission regulation. Before performing any significant act—construction of new facilities or initiation of new transportation service or new sales for resale—they must secure a certificate of convenience and necessity from the Commission. NGA § 7(c), 15 U.S.C. § 717f(c) (1982). They also require Commission approval when they abandon any "certificated" facility, transportation or sale. NGA § 7(b), 15 U.S.C. § 717f(b) (1982). Finally, the Commission limits to "just and reasonable" levels the prices at which the interstates sell gas for resale or provide transportation service. NGA § 4(a), 15 U.S.C. § 717c(a) (1982). Under conventional

public utility principles this allows the pipelines, at least in theory, to recover no more than cost of service, including a reasonable return on investment.

LDCs purchase gas for resale to end users, large and small. Their services and prices are subject to state regulation but not to that of FERC.

End users run the gamut both in size and in ability to use substitutes. At one end is the ordinary householder, who even in the intermediate run in limited to such expedients as installing better insulation, wearing more sweaters, or turning the thermostat down. At the other end of the spectrum are users that need only flick a switch to replace gas with oil.

B. *Regulatory and Economic Context.*

The Natural Gas Act has the fundamental purpose of protecting interstate gas consumers from pipelines' monopoly power. *See* Sen. Doc. No. 92, part 84A, 70th Cong., 1st Sess. 588-91 (FTC Utility Corporations Rep. 1935). By the early 1980s, a number of developments suggested, for the first time since enactment, that assuring customer access to the wellhead market could be an important potential ingredient in Commission fulfillment of that goal. First, by then a nationwide pipeline network had matured. J.A. 279, 284-92. This made it physically possible, for the first time, for consumers to acquire gas supplies from virtually any region. It also ended, or at least sharply reduced, pipeline monopsony power over wellhead purchases, a power that had the tendency to keep wellhead prices below competitive levels. *See* S. Breyer, *Regulation and its Reform* 243 (1982); *cf.* Note, *Federal Price Control of Natural Gas Sold to Interstate Pipelines*, 59 Yale L.J. 1468, 1478-79 (1950).

Second, the removal of wellhead price controls greatly increased an underlying risk of the regulatory system—that pipelines' gas purchase costs would rise above competitive market levels. For while cost-based price regula-

tion at least in principle prevented pipelines from enjoying monopoly profits, the combination of market power and regulation tended to blunt their incentives for careful gas purchasing. The pipelines' market power dampened any fear of being unable to recover exorbitant costs; regulation dampened any hope of direct profit from thrifty purchases, as it prevented them from making any mark-ups not based on cost. *Cf. Pierce, Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 345, 357-65 (1983). As it proved, this lulling effect of regulation—coupled with the gyrations of the energy market from 1973 to the present—brought on the phenomenon of embedded contract prices well above competitive levels at the wellhead. For example, the Commission has recently estimated average prices paid by pipelines at the wellhead at about $2.50 per thousand cubic feet ("Mcf"), compared with less than $2 per Mcf in the spot market. *See* Order No. 451, III FERC Statutes & Regulations ¶ 30,701, at 30,210 (1986). (If the volume of the interstate market is about seven trillion cubic feet ("Tcf"), this would amount to a $3.5 billion price discrepancy.) The Commission's estimate of the price specified in long-term new contracts as of mid-1986 was about the same as the average price then being paid by the pipelines (about $2.50), *see id.*; but the pipelines attained their figure for average price actually *paid* in part by refusing to take high-priced gas and thus subjecting themselves to a build-up of very substantial take-or-pay liability (discussed immediately below).

Third, the conditions under which the NGPA began to relax wellhead price controls—namely acute gas shortage and sharply rising prices for alternative fuels—tended to divert pipeline attention from the hazards of incurring long-term obligations to buy high-priced gas. Under pressure from the Commission, the pipelines had typically purchased gas under contracts for very long terms. *See, e.g.*, 18 C.F.R. § 2.61 (requiring pipelines to maintain

supply reserves of up to 12-years' projected demand); *Columbia Gas Transmission Corp.*, 21 F.E.R.C. ¶ 61,026, at 61,160-61 (1982) (example of long-term supply arrangements pipeline must make in order to extend new service); Department of Energy, *The First Report Required by Section 123 of the National Gas Policy Act of 1978* 3-2 (1984) (producer-pipeline contracts for 10 or more years are common). Besides incorporating high prices (and provisions for escalation upward), the contracts commonly included "take-or-pay" provisions, requiring the pipeline to pay for some specified percentage, say 75%, of the deliverable gas even if it took less. While usually subject to recoupment later, and while a perfectly natural allocation of risk between producer and purchaser, the take-or-pay provisions effectively committed the pipelines to high gas costs in what by 1982 proved to be a time of falling prices, both for competing fuels and for substitute supplies of gas not covered by contract.

Fourth, various economic forces, including exhaustion of the cheaper supplies and the decline of pipeline monopsony at the wellhead, *see* S. Breyer, *Regulation and Its Reform* 243 (1982), raised the wellhead price—and thereby the potential loss to consumers if they should be saddled with the results of pipelines' readiness to bid high prices. After hovering in the range of $.50 (in constant 1984 dollars) per million British thermal units ("Btu") from 1930 to 1973, it rose to over $2.50 by 1982. *See* Energy Information Administration, *An Analysis of the Department of Energy's Notice of Proposed Rulemaking (NOPR), "Ceiling Prices: Old Gas Pricing Structure"* 3 (1986). While the wellhead price in 1972 represented only about 28% of the delivered price to consumers, by 1981 that fraction had risen to 57%. *Id.* at 5.

These developments lie in the background of the key Commission findings in support of Order No. 436. (1) Despite the growth of a competitive wellhead market, the

interstate pipelines retain market power in gas transportation. J.A. 306. (2) Pipelines have generally declined to transport gas in competition with their own sales (except for transportation to customers that can switch to alternative fuels at little or no extra cost). J.A. 318-19. (3) Pipeline discrimination in transportation has denied consumers access to gas at the lowest reasonable rates. J.A. 320, 352.

Thus the early 1980s created the likelihood, for the first time, that the Commission could best fulfill the purposes of the NGA by adopting rules enabling customers to buy gas at the wellhead and to overcome the interstate pipelines' general refusal to move gas that would compete with their own sales. Besides protecting consumers from the burden of the pipelines' purchase contracts at supra-market prices, such rules would have the long-term effect of subjecting pipelines to the ordinary constraints of a middleman under competitive conditions. This the Commission set out to achieve in Order No. 436.

The Order's regulatory package includes these elements: (1) If a pipeline seeks to take advantage of "blanket certification" of transportation (*i.e.*, a certificate authorizing transportation services generically and thus obviating the need for unwieldy individual certification), it must commit itself to provide transportation on a nondiscriminatory basis (and thus become an "open-access" pipeline). (2) When demand outruns capacity for open-access transportation, the open-access pipeline shall allocate capacity on a "first-come, first-served" basis. (3) Rate regulation for open-access transportation will take the form of ceilings and floors, with the pipeline free to adjust rates within that band. (4) Any open-access pipeline, by applying for certification, agrees to allow its LDC customers to convert their "contract demand" ("CD") (*i.e.*, contract commitment to purchase gas) from an obligation to purchase gas to an obligation to use (or pay for) transportation services. The point of

the option is to make open access a reality for the pipelines' LDC customers despite long-term contractual service arrangements previously certificated by the Commission. The Order also requires an open-access pipeline to give its LDC customers the option to reduce contract demand. (5) The Commission will issue "Optional, Expedited Certificates" for new facilities, services and operations where the pipeline undertakes the entire economic risk of the project. The Commission declined to include in the package any special provision to relieve pipelines from the burden of take-or-pay contracts providing for prices well above current competitive levels.

Each component of the package contains many details not given above, some of them the source of challenges in this case. The details will be developed as appropriate in the opinion.

II. Open-Access Requirements

A. *Claimed Deficiencies in Statutory Authority to Require Open Access.*

Order No. 436 imposes an "open-access" commitment on any pipeline that (1) secures a "blanket certificate" to provide gas transportation, pursuant to § 7 of the NGA, 15 U.S.C. § 717f (1982), or (2) actually provides transportation under § 311 of the NGPA, 15 U.S.C. § 3371 (1982). *See* 18 C.F.R. §§ 284.8(b), 284.9(b).[3] Several pipelines and others attack these conditions as beyond the scope of the Commission's authority under the two statutes. The arguments under both statutes rely on the proposition that the "open-access" condition is equivalent to a "common carriage" requirement, as both the condition and common carriage have at their core a duty to accept shipments from all would-be shippers. The two

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[3] Except where indicated otherwise all citations to the Code of Federal Regulations are to the 1986 edition.

statutes differ radically in their languages, however, so we treat the claims separately, rejecting both.

1. *Natural Gas Act.*

The pipelines can point to no language in the NGA barring the Commission from imposing common carrier status on natural gas pipelines, and certainly none barring it from imposing upon the pipelines a specific duty that happens to be a typical or even core component of such status. They seek to overcome the statutory silence by means of legislative history. The task is uphill; "courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point." *IBEW, Local No. 474 v. NLRB*, 814 F.2d 697, 712 (D.C. Cir. 1987) (emphasis deleted) (citing *United States v. American College of Physicians*, 106 S. Ct. 1591, 1598 (1986)).

The legislative history here consists entirely of congressional inaction. In 1906, when Congress brought oil pipelines under the wing of the Interstate Commerce Commission, it amended the Interstate Commerce Act to exclude natural gas pipelines from the category of common carrier, thus making clear that they were not covered by the extension of jurisdiction. Pub. L. No. 59-397, § 1, 34 Stat. 584, 584 (codified as amended at 49 U.S.C. §§ 10,102, 10,501 (1982)). In 1913 a bill was introduced in the Senate that would have reversed the 1906 decision, *see* S. 3345, 63d Cong., 2d Sess., 50 Cong. Rec. 5847-49 (1913), but it was never enacted. Finally, in 1935 a bill presaging the NGA—similar to the ultimate statute but explicitly imposing common carrier duties—died in committee. *See* H.R. 5423, 74th Cong., 1st Sess., 70 Cong. Rec. 1624 (1935).

This history provides strong support only for the point that Congress declined itself to impose common carrier status on the pipelines—a proposition that is unquestioned and is evident from the language of the statute

itself. The chain of inference gets steadily weaker as we move toward more relevant issues. The history supplies modest support for the view that Congress did not intend the Commission to impose common carriage conditions at will. It affords weak—almost invisible—support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty.

The weakness of the legislative history is underscored when we examine the very component of "common carriage" on which the challenging pipelines rest their case: the duty to carry without discrimination. Insofar as they argue that a concern about discrimination has been a driving force behind legislative imposition of common carriage regulation, history is on their side. *See, e.g., Louisville & Nashville R.R. v. United States*, 282 U.S. 740, 749-50 (1931); L. Gorton, *The Concept of the Common Carrier in Anglo-American Law* 42-43 (1971). But in the NGA Congress affirmatively addressed itself to that issue, giving the Commission power to stamp out undue discrimination; it is precisely that power that the Commission has here sought to exercise.

The Act fairly bristles with concern for undue discrimination. Section 4 prohibits any "undue preference" and any "unreasonable difference in rates, charges, service, facilities, or in any other respect," and empowers the Commission to review tariffs filed by pipelines in order to reject ones violating the prohibition. 15 U.S.C. § 717c (1982). Section 5—the primary authority invoked by the Commission here—directs the Commission to adopt corrective measures whenever it finds a "rate, charge or classification," or any "rule, regulation, practice, or contract" affecting the same, to be "unjust, unreasonable, unduly discriminatory, or preferential." *Id.* § 717d.

The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage

regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress, in 1906 and 1914 and 1935 and 1938 itself, refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.

Thus we find little relevance in cases relied on by the pipelines for the proposition that a duty to provide service to all comers is the essence of common carriage. In each of those cases the court was construing the term as used in a statute, in one instance stating that a particular class of persons "shall not . . . be deemed a common carrier," *FCC v. Midwest Video Corp.*, 440 U.S. 689, 699-702 (1979), in the others prohibiting agency exercise of jurisdiction over activities of certain persons classified as common carriers, *see National Ass'n of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630 (D.C. Cir. 1976); *National Ass'n of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601 (D.C. Cir. 1976). Such cases are not helpful on the issue of whether Congress's omission of the term common carrier significantly undercuts its explicit provision of authority to prevent or correct undue discrimination.

Petitioners cite *Florida Power & Light Co. v. FERC*, 660 F.2d 668 (5th Cir. 1981), and *Richmond Power & Light v. FERC*, 574 F.2d 610 (D.C. Cir. 1978), for the following proposition: that any order by the Commission conditioning its approval of any "wheeling" (*i.e.*, transmission of electricity owned by another) on the utility's agreement to wheel for all constitutes an attempt by the Commission to impose indirectly duties that the Federal Power Act prevents it from imposing directly, namely

common carriage. As the Federal Power Act establishes a regulatory scheme for electricity paralleling that which the NGA creates for gas, *see, e.g., FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956), petitioners contend that the *Richmond* and *Florida* cases compel invalidation of the Comission's open-access condition.

We think petitioners read *Richmond* and *Florida* far too broadly. First, we note that the legislative history of the two acts is, on this point, materially different. In its deliberations on the bill that ultimately emerged as the Federal Power Act, Congress considered and rejected a provision that would have "empowered the Federal Power Commission to order wheeling if it found such action to be 'necessary or desirable in the public interest.'" *Otter Tail Power Co. v. United States*, 410 U.S. 366, 374 (1973) (quoting S. 1725, 74th Cong., 1st Sess.). The evidence as to the NGA (surveyed above) is less direct: it consists exclusively of various occasions on which Congress did not adopt proposals actually making the natural gas pipelines into common carriers.

Second, neither *Richmond* nor *Florida* comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances. In *Florida*, the court expressly left open the question whether the Commission would be entitled to use open-access conditions as a remedy for anti-competitive conduct. 660 F.2d at 677-79. It stressed the failure of the Commission, in the orders under review, to "make any findings of anti-competitive activities or violations." *Id.* at 678. Evidently because no party raised the issue, the court did not address the Commission's power to exact such conditions as a remedy for undue discrimination. *Cf. FPC v. Conway Corp.*, 426 U.S. 271, 276-77 (1976) (accepting assumption that the Commission could not remedy a utility's discrimination between wholesale (jurisdictional) rates and retail (nonjurisdictional) rates by ordering increases in the latter).

In *Richmond* the Commission had repulsed Richmond Power & Light's demand that it condition approval of any transmission by either of two large interstate systems on their agreeing to transmit for all. In upholding the Commission we said little more than that unwillingness to transmit for all comers could not be automatically deemed an undue discrimination:

> Thus Richmond spurned the opportunity to demonstrate that particular activities were unreasonably anticompetitive or discriminatory and claimed instead that the mere failure to wheel energy to and from Richmond while wheeling for any other utility was unlawful discrimination.

574 F.2d at 623. We went on to say that the Commission's rejection of a *per se* rule (*i.e.*, a rule that selective transmission was necessarily undue discrimination) followed logically from Congress's refusal to impose common carrier duties on electric utilities. *Id.*

Petitioners' reading of *Richmond*, moreover, is belied by this court's later decision in *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156 (D.C. Cir. 1979). Pursuant to § 205 of the Federal Power Act, 15 U.S.C. § 824d (1982) (paralleling § 4 of the NGA), the Commission had reviewed the terms of a power-pooling agreement that established two classes of membership, one of them entitled to fewer privileges than the other. Finding the distinction discriminatory on its face, the Commission conditioned its approval on removal of the membership criteria that prevented the inferior class of participants from enjoying the privileges of the favored ones. We upheld the decision as a proper exercise of its power to prevent undue discrimination. 606 F.2d at 1170-72. *See* Reiter, *Competition and Access to the Bottleneck: The Scope of Contract Carrier Regulation Under the Federal Power and Natural Gas Acts*, 18 Land & Water L. Rev. 1, 47-50 (1983). The Commission's open-access condition relies on precisely that principle.

It is true that in *Central Iowa* the court rejected South Dakota's claim that the Commission should have conditioned approval of the power-pooling agreement on the parties agreeing to wheel for nongenerating electrical systems. *See* 606 F.2d at 1169. Such a condition would in effect have forced on the participants a broad extension of their agreement to wheel for each other. *See id.* at 1160 n.7. Though the court brushed the request aside in fairly sweeping language, its approval of the Commission's elevation of the inferior class of members clearly limits the negative impact of the discussion. The case upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users.

Neither *Florida* nor *Richmond* presented the extreme factual circumstances that are now present in the gas industry. Here the Commission has found (a) that pipelines continue to possess substantial market power, J.A. 306; (b) that they have exercised that power to deny their own sales customers, and others without fuel-switching capability, access to competitively priced gas, J.A. 318; and (c) that this practice has denied consumers access to gas at the lowest reasonable rates, J.A. 318-21, 352. Thus, despite the removal of regulation over the price and non-price aspects of wellhead transactions, and the evolution of an interconnected nationwide pipeline grid, discrimination in transportation has denied gas users, and the economy generally, the benefits of a competitive wellhead market.

Despite a sweeping suggestion that the Order is "unsupported," Brief of Interstate Pipeline Group at 35, the pipelines do not in fact challenge these factual findings. Their objection is rather on matters of policy, grounded on beliefs that the kind of discrimination here prohibited is not "undue" within the meaning of the NGA.[4] Indeed,

[4] Attacks on the Order for failure to take account of preferences based on pipeline contracts with particular customers are

the burden of their attack on the Order is precisely that it may disable them from passing on to customers gas purchase costs that they incur under contracts entered into years ago under premises now obsolute. *Id.* at 37-38. In other words, enforcement of Order No. 436 will expose them to competition that their discriminatory practices enable them to avoid. Their claim thus tends to substantiate the Commission's views (1) that in the absence of Order No. 436 competition will be thwarted and (2) that the practices controlled by Order No. 436 are indeed anticompetitive and discriminatory.

The electricity cases cited thus provide only very weak support for the challenge. In contrast, our decision in *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*"MPC II"*), came about as close to endorsing the Commission's approach as Article III permits. There we vacated orders of the Commission that had established "blanket certificate" transportation *without* any specific effort to prevent pipelines from offering such transportation on a discriminatory basis. We did not, of course, explicitly find "undue discrimination" such as would obligate the Commission to act under § 5. But we did find that the petitioners there had made a strong enough showing to require the Commission to address the issue. Specifically, we made it clear that blanket-certificate transportation, unconstrained by any nondiscriminatory access provision, might well require remedial action under § 5. We ended by saying:

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discussed below in consideration of problems of capacity allocation. *See infra* part II.C.2. Insofar as the pipelines claim that prohibitions of undue discrimination must be based upon *individualized* findings, the cases on which they rely, *American Smelting & Rfg. Co. v. FPC*, 494 F.2d 925, 939-41 (D.C. Cir.), *cert. denied*, 419 U.S. 882 (1974); *Louisiana Power & Light Co. v. FPC*, 526 F.2d 898, 905-07 (5th Cir. 1976), are plainly inapposite. *See Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1165-68 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986).

> We vacate the challenged orders to the extent that they allow transportation of direct-sale gas to fuel-switchable, non-"high-priority" end users without requiring pipelines to furnish the same service to LDCs and captive consumers on nondiscriminatory terms.

761 F.2d at 789 (footnote omitted).

Our holding in *MPC II* obviously did not require the Commission to make the findings that it has. It surely carried the implication, however, that if it did make supportable findings of undue discrimination in pipeline use of the old blanket certificates, it would have the authority to employ suitable remedies. And it carried the further implication that among them might be a requirement that any pipeline offering blanket-certificate transportation agree to serve "LDCs and captive consumers on nondiscriminatory terms." *Id.*

The interstate pipelines appear to suggest that Order No. 436's impact on their financial integrity is so grave as to be equivalent to a rule denying them the legal right to pass on costs, and invalid as such a rule would be. It is true that the Commission has only very limited power to deny the pipelines the *legal* right to pass gas purchase costs through to customers. *See* § 601(c)(2) of the NGPA, 15 U.S.C. § 3431(c)(2) (1982) (providing that the Commission must allow interstate pipelines to pass through gas costs not violating NGPA wellhead ceilings "except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds"); *Office of Consumers' Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986). But petitioners have called our attention to nothing that bars the Commission from devising rules that remedy a lack of competition by exposing pipelines to competition and its normal consequences. The Supreme Court has made clear, for example, that the due process clause affords no protection

from losses inflicted by market conditions. In *Market Street Ry. v. Railroad Comm'n*, 324 U.S. 548 (1945), it said of its decision in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944):

> All that was held was that a company could not complain if the return which was allowed made it possible for the company to operate successfully. There was no suggestion that less might not be allowed when the amount allowed was all the company could earn. . . . The due process clause . . . has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.

324 U.S. at 566-67. Similarly, nothing in the NGA protects the pipelines from the market forces to which Order No. 436 subjects their gas marketing business, even though those forces are derived in part from a restriction on their discrimination in transportation.

It is finally argued that the Commission's not having imposed any requirements like those of Order No. 436 in the period from enactment in 1938 until the present demonstrates the lack of any power to do so. *Cf. FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513-14 (1949). But as our introductory review of the economic background sought to illustrate, the Commission here deals with conditions that are altogether new. Thus no inference may be drawn from prior non-use.

While the Supreme Court's decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), it is not a wand by which courts can turn an unlawful frog into a legitimate prince, the case bolsters our conclusion. Congress has given the Commission in § 5 of the NGA a broad power to stamp out undue discrimination; in § 7 the power to approve certificates of service subject to "such reasonable terms and conditions as the public convenience and necessity may

require"; and in § 16 the power to "perform any and all acts, and to prescribe . . . such orders, rules, and regulations as it may find necessary or appropriate to carry out the [NGA's] provisions." The alleged negative restriction on this power is at best ambiguous, if indeed it exists at all. Under these circumstances, *Chevron* binds us to defer to Congress's decision to grant the agency, not the courts, the primary authority and responsibility to administer the statute. The Commission's view represents "a reasonable interpretation" of the Act, for which we may not substitute our view. 467 U.S. at 844.

2. *Natural Gas Policy Act.*

In enacting the NGPA Congress endeavored to break down the regulatory barriers between the interstate and intrastate markets. Sections 311 and 602(b)(2) were added to "facilitate[] development of a national natural gas transportation network without subjecting intrastate pipelines, already regulated by State agencies, to FPC regulation over the entirety of their operations." H.R. Rep. No. 543, 95th Cong., 1st Sess. 45 (1977). *See also Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342-43 (1983). Thus, § 311(a) permits the Commission to authorize transportation by an interstate pipeline on behalf of an intrastate or LDC and by an intrastate on behalf of an interstate or LDC. 15 U.S.C. § 3371(a) (1982). The Commission has exercised this authority, permitting such transportation as a general matter. *See* 18 C.F.R., part 284, subparts B and C. It has also exercised the authority provided by § 311(c), 15 U.S.C. § 3371(c) (1982), to prescribe terms and conditions.[5] Order No. 436 would add to these the requirement that any interstate or intrastate pipeline offering such transportation shall do so on a nondiscriminatory basis. 18 C.F.R. §§ 284.8(b) and 284.9(b). Petitioners challenge these open-access conditions, relying here on

[5] "Any authorization granted under this section shall be under such terms and conditions as the Commission may prescribe." *Id.*

express statutory language. Section 602 of the NGPA, captioned "Effect on State Laws," provides in subsection (b):

> (b) Common carriers.
>
> No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—
>
> (1) pursuant to any order under section 3362 (c) or section 3363(b), (c), (d), or (i) of this title; or
>
> (2) authorized by the Commission under section 3371(a) of this title [section 311(a) of the NGPA].

15 U.S.C. § 3432(b) (1982).

Petitioners read this language as stultifying any effort by the Commission to control discrimination where that effort imposes on pipelines a duty—even though it be a conditional one—equivalent to the common carrier's duty to provide nondiscriminatory service. We believe this interpretation is incorrect.

It seems to us that § 602(b)(2) was a congressional effort to protect § 311(a) from the consequences of pipeline concern that service thereunder would expose them generally to classification as common carriers, most likely by states, and thus to an unprecedented range of legal burdens. If pipelines shied away from use of § 311(a), its purpose would be defeated. Section 602(b)(2) could protect against that threat by assuaging the pipelines' concern. A duty not to discriminate, imposed by the Commission on the basis of findings that the duty is necessary to assure consumers access to competitively priced gas, is utterly different. The imposition of the duty here facilitates the accomplishment of Congress's purposes. At least it will do so if the gains in enhanced access offset whatever losses may result from the disincentive effect

on pipelines. The judgment balancing those consequences is for the Commission to make, and it has made it in favor of imposing the duty.[6]

Congress had ample reason to fear that the risk of extraneous legal burdens would chill pipeline interest. Take the laws of Texas. Two years before enactment of the NGPA a Texas court ruled that "[w]hether the business conducted by a pipe line company is actually that of a common carrier is a question of fact," which would depend on the court's perception of whether "the line is available to all producers seeking its service." *China-Nome Gas Co. v. Riddle*, 541 S.W.2d 905, 908 (Tex. Civ. App. 1976). A pipeline's transportation under § 311(a) would expose it to the risk of such "fact" findings, and thus enmesh it in state regulations. In Texas, for example, such classification would subject it to the jurisdiction of the Railroad Commission, *see Op. Atty. Gen.* No. M-175 (1967), to certain health requirements, *see Tex. Civ. Stat. Ann.* § 4477-1(1) & (22) (Vernon 1976 & Supp. 1987), and to such duties and liabilities as a court might find the common law to prescribe, *see id.* §§ 882-884 (Vernon 1964 & Supp. 1987). Most notably, a firm declared a common carrier is required under Texas law to carry, for anyone, any goods of the type for which it is suited. *Id.* § 884.

Pipeline fear of such extraneous burdens might well have rendered § 311 a dead letter. Though we have not identified similar federal hazards, we believe that Congress might well have included the reference to federal law out of anxiety that some overlooked federal provision would operate to thwart § 311's purposes. Viewed in this light, § 602 has nothing to do with a Commission decision to impose a duty of nondiscrimination.

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[6] Thus we reject attacks predicated merely on a view that pipelines will prefer to give up § 311 transportation altogether rather than submit to the conditions that Order No. 436 imposes. *See, e.g.*, Brief of the American Gas Ass'n at 37-41.

The structure of § 602 favors this reading over the broader one urged by the petitioners. Section 602 also provides that no one shall be subject to regulation as a common carrier by reason of providing transportation under 15 U.S.C. §§ 3362(c) or 3363(b), (c), (d), or (i), which involve presidential orders to transport in a natural gas supply emergency. The President's emergency powers are extremely broad, and their exercise could well impose duties quite like those of common carriage, with the President dictating detailed priorities about whom the pipelines should serve. *See id.* § 3363. If the President determined that imposition of something like common carriage were necessary to meet such an emergency, it is hardly credible that § 602 would stand in the way. By the same token, that section must not flatly bar the Commission from imposing similar conditions on gas transportation under § 311.

Congress may conceivably have intended § 602 to bar FERC from conditioning § 311 transportation upon assurances of nondiscrimiantion. We doubt it. But apart from our independent conclusion that it has no such purpose, we regard FERC's interpertation as reasonable. The reasonableness is underscored by FERC's broad duties to assure consumers access to natural gas at prices such as would prevail in the absence of pipeline market power and its conclusion that under the present circumstances fulfillment of that duty requires such conditioning. *Cf. American Trucking Ass'ns, Inc. v. Atchison, T. & S.F. Ry.*, 387 U.S. 397 (1967). We are therefore under *Chevron* bound to uphold the Commission.

A parallel attack on Order No. 436 stresses § 601(a)(2)(A) of the NGPA, 15 U.S.C. § 3431(a)(2)(A) (1982), providing that transportation under § 311 (or under the Presidential emergency powers discussed above) shall not constitute "transportation in interstate commerce" within the meaning of § 1(b) of the NGA. But for this provision, a transporting intrastate pipeline would

fall prey to the Commission's NGA jurisdiction. Several petitioners argue that Order No. 436 imposes burdens substantially identical to those encompassed by NGA jurisdiction. Thus, they argue, application of the open-access condition to intrastate pipelines is an impermissible interference with state regulatory authority. *See* Brief of the American Gas Ass'n at 42-43; Brief of Intrastate Petitioners & Intervenors at 22-29.

Again consideration of the purpose of the provision refutes the attack. Section 602(a)(2)(A) is clearly intended to assure that pipelines' fear of the *automatic* imposition of the burdens of NGA jurisdiction does not make them so chary of § 311 that it languishes unused. This is altogether different from regulatory burdens imposed by the Commission in the exercise of its discretion under § 311(c) in order to make sure that § 311 transportation operates in harmony with the congressional purpose. Thus, even if it were true that the regulatory impact of Order No. 436 were identical to that of NGA jurisdiction, the decision to condition § 311 on acceptance of those burdens would not violate § 601(a)(2)(A).

In fact, of course, the nondiscrimination duties imposed by Order No. 436 by no means encompass all the burdens of NGA jurisdiction. (1) New service under § 311 does not require § 7 certification, and Order No. 436 carries that distinction forward where a pipeline brings itself under the Order: operations under a § 7 blanket transportation certificate entail notice-and-protest procedures more burdensome than the reporting requirements for § 311 transportation. *See infra* part VII.B. (2) Construction of facilities to be used exclusively for § 311 transportation requires no certification or FERC review at all. *See infra* part VII.D. (3) § 311 transportation does not subject an intrastate pipeline to the detailed accounting provisions applicable to a natural gas company under the NGA. *Compare* 18 C.F.R. part 201. (4) Intrastate pipelines may provide firm *or* interruptible

service without providing both, while interstate pipelines providing one type must also provide the other. *Compare* 18 C.F.R. §§ 284.8(a)(1) & 284.9(a)(1) *with id.* §§ 284.8(a)(2) & 284.9(a)(2).

B. *Alleged Failure to Comply with Mandate of Outer Continental Shelf Lands Act.*

The Petitioner Industrial Groups (the Process Gas Consumers Group and American Iron and Steel Institute) claim that under §§ 5(e) and 5(f) of the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1334(e) & (f) (1982), the Commission must require every gas pipeline operating in the OCS to provide nondiscriminatory access for others' OCS gas throughout the entire system of the "pipeline entity."

Congress included § 5(e)[7] in OCSLA at the time of original adoption, and then sought to "strengthen[]" it[8] in 1978 by adding § 5(f):

> (f) Competitive Principles Governing Pipeline Operation

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[7] Section 5(e) provides:

> Rights-of-way through the submerged lands of the outer Continental Shelf, whether or not such lands are included in a lease maintained or issued pursuant to this subchapter, may be granted by the Secretary for pipeline purposes for the transportation of oil, natural gas, . . . upon the express condition that oil or gas pipelines shall transport or purchase without discrimination, oil or natural gas produced from submerged lands or outer Continental Shelf lands in the vicinity of the pipelines in such proportionate amounts as the Federal Energy Regulatory Commission, in consultation with the Secretary of Energy, may, after a full hearing with due notice thereof to the interested parties, determine to be reasonable taking into account, among other things, conservation and the prevention of waste.

43 U.S.C. § 1334(e) (1982).

[8] H. Conf. Rep. No. 95-1474, 95th Cong., 2d Sess. 87, *reprinted in* [1978] U.S. Code Cong. & Admin. News 1674, 1686.

> (1) Except as provided in paragraph (2) [the gathering exemption], every permit, license, easement, right-of-way, or other grant of authority for the transportation by pipeline on or across the other Continental Shelf of oil or gas shall require that the pipeline be operated in accordance with the following competitive principles:
>
> (A) The pipeline must provide open and nondiscriminatory access to both owner and nonowner shippers. . . .

43 U.S.C. § 1334(f) (1982).

The language will not bear the proposed load. The statute demands that any permit for *transportation by pipeline* on the OCS require that "the *pipeline*" be operated according to specified principles. The natural reading is that the subject pipeline is the physical facility in the OCS, not every facility owned or operated by the corporation operating that facility. The petitioners call our attention to remarks on the Senate floor reflecting concern about pipeline discrimination. See, for example, Senator Kennedy's observation, "This amendment seeks to insure that OCS pipelines are true common carriers." 123 Cong. Rec. 23,252 (July 15, 1977). But none of the remarks supports petitioners' proposed inference. All are completely consistent with a focus on what Congress had before it—the OCS.[9]

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[9] The same petitioners object to the Commission's allowing a pipeline to offer blanket certificate transportation under § 311 without offering it under § 7 as well. *See* 18 C.F.R. part 284, subparts B and G. This allows a pipeline to provide open access to pipelines and LDCs without offering it *directly* to end users. In the absence of evidence that this decision will seriously impede access for the sort of end user that can buy gas for itself in the wellhead market, we decline to interfere with the Commission's distinction between transportation under the NGPA and transportation under the NGA—a distinction that the pipelines assert has eroded too much.

C. *Claims of Arbitrariness and Caprice.*

1. *Failure to impose the nondiscriminatory access conditions on § 7(c) transportation certificates.*

Maryland People's Counsel finds Order No. 436 defective in that it (potentially) allows a pipeline to provide transportation under an individual certificate issued under § 7(c) without agreeing to provide the same on a nondiscriminatory basis.

We lack jurisdiction over the claim. Section 19(a) of the NGA, 15 U.S.C. § 717r(a) (1982), prohibits any "proceeding to review" an order of the Commission in the absence of an application for rehearing filed within 30 days after issuance of the order, setting forth specifically the ground on which the application is based. The Commission addressed the problem of individual § 7 certificates in Order No. 436, stating in its analysis of comments that it did not intend to apply the nondiscriminatory access provision "on a generic basis to all section 7 certificates at this time." J.A. 388. MPC did not file an application raising the point until March 1986, long after expiration of the 30 days from issuance of Order No. 436 on October 9, 1985.

MPC acknowledges the jurisdictional difficulty, but states that it could not have realized, until February 1986, that the Commission's refusal encompassed certificates for transportation to fuel-switchable customers. At that time, in *Texas Gas Transmission Corp.*, 34 F.E.R.C. ¶ 61,203 (1986), the Commission actually did issue such a certificate without open-access conditions. MPC argues that, in view of the obligations imposed by *MPC II*, and language of the Commission elsewhere in Order No. 436, it was entitled to believe that the Commission's statement referred only "to transport in support of [the pipelines'] merchant function (*e.g.*, where one pipeline transports gas owned by another pipeline) or in ways that would not create the discrimination that the

Commission found unlawful in Order No. 436 (*e.g.*, transportation for high priority customers . . .)." Reply Brief of MPC at 4.

We must reject MPC's reading of Order No. 436's disclaimer. The statement is broadly phrased to encompass "section 7 transportation certificates," and is justified in terms of the Commission's opportunity to scrutinize "individual section 7 transportation arrangements . . . on a case-by-case basis when [the certificates] are applied for." J.A. 388. Both the language and the explanation are fully as applicable to transportation to fuel-switchable users as to any other transportation. MPC of course remains free to challenge the policy by seeking review of individual § 7 orders in which the Commission applies it.

The Commission briefly sought to refute MPC's contention in Order No. 436-D, issued on March 28, 1986. Such discussion was merely dictum, as MPC's March 1986 application was time-barred under § 19 and the Commission so recognized. In any event, the Commission cannot waive the jurisdictional bar of § 19 by selective discussion of belated rehearing applications. *See Boston Gas Co. v. FERC*, 575 F.2d 975, 979-80 (1st Cir. 1978).

2. *Capacity allocation on a "first-come, first-served" basis.*

Several parties attack as arbitrary and capricious the Commission's "first-come, first-served" formula for determining priorities among those who seek transportation service under the Order.

The Commission did not announce this formula in any regulation but merely in material supporting the regulations. *See* J.A. 342, 401-04. It also said that certain claims on pipeline capacity might enjoy favored treatment, "outside the general first-come, first-served rule." J.A. 400. These preferred claims include those of "a firm

sales customer," on the grounds that such a customer "has *already* booked the transportation capacity currently 'bundled' with . . . the sale." *Id.* (emphasis in original). A similar special priority applies to LDCs that exercise the CD conversion option discussed in part IV of this opinion. *Id.* at 401. Further, the "first-come, first-served" concept is evidently not to apply in cases of sudden capacity interruption, but only to the process of "*contracting* for available capacity." *Id.* at 1095-96 (emphasis in original). *But see El Paso Natural Gas Co.*, 35 F.E.R.C. ¶ 61,440, at 62,061 (June 27, 1986).

Apart from introducing the complexity of these exceptions and superior claims, Order No. 436 and its supporting statements contain no guidance about how pipelines are to implement this formula. "First come, first served" is an easy principle to apply in a bakery where each customer pulls a numbered ticket on entering and is served in that order. But in an industry such as natural gas transportation it may often be difficult to say who "comes first."

Here are a few sample questions that the rule fails to resolve: (1) Suppose that *A*, an end user, contracts with a pipeline for the right to transmit up to five billion Btu per day for five years. At the end of four years *A* seeks to renew the contract on the same terms. But others have earlier filed requests that in the aggregate exceed the pipeline's capacity. Does *A* go to the end of the line? Such a result would probably disrupt most notions of ordinary business arrangements in this market. But if *A* and persons similarly situated enjoy a sort of super-priority, open access will be an empty promise for new would-be users. (The Commission appears to lay great stress on the date on which a request is filed, J.A. 1191, but the full implications are nowhere spelled out.) (2) What of efforts by *A* to secure not merely continued but additional transportation at the end of a fixed-term contract? Would *A* go to the end of the line for the

increment? (*See El Paso Natural Gas Co., supra,* at 62,060.) (3) What is the impact of a minor change in point of receipt? If such a change forces the user to go to the end of the line, then an LDC or end user may find it hard to shift from one supplier to another. *See* Brief of Baltimore Gas & Elec. Co. at 17. (4) May a pipeline charge a fee for accepting requests for service? If not, how can it prevent all potential users from filing immediately for virtually unlimited claims on capacity for an indefinite period of time?

The most potent objection to the Commission's treatment of the problem—and one that is unquestionably ripe—is the contention that it leaves an intolerable gap in the regulatory structure. That gap creates some risk that pipelines may use the resulting leeway to persist in the discrimination that Order No. 436 nominally forbids. It leaves even the most willing pipeline uncertain as to what full compliance requires. On the other side, shippers cannot know what steps they must take to secure adequate priority status or what should guide them in choosing between bundled and unbundled service.

The Commission's brief treats the problem dismissively, noting that aggregate annual gas consumption has fallen from a peak of 22.6 trillion cubic feet in 1973 to only about 17-18 Tcf currently. FERC Brief at 101. This comment seems utterly irrelevant: the problem is surely capacity at *peak* periods. The Commission expressly concedes that generally pipelines have operated at capacity during the winter peak. *See* FERC Brief at 103 n.3; J.A. 280.

Nonetheless, as each pipeline elects to become an open-access transporter, it must file tariffs with the Commission to govern the service, which tariffs must include any "operational conditions" the pipeline proposes to apply. 18 C.F.R. §§ 284.7(a), 284.8(c), 284.9(c). *See, e.g., El Paso Natural Gas Co.*, 35 F.E.R.C. ¶ 61,440 (June 27, 1986). These filings afford the Commission an opportu-

nity to develop standards of permissible capacity allocation. Accordingly, the essential legal issue is the validity of the Commission's choice to address the problem in that format rather than in the format of generic rulemaking.

It is clear that this choice "lies primarily in the informed discretion of the administrative agency." *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947). The Supreme Court has noted that such resolution is appropriate where problems arise that the agency could not reasonably foresee, or where its experience makes adoption of a "hard-and-fast" rule unsuitable, or where the problem is so specialized and variable as to be "impossible of capture within the boundaries of a general rule." *Id.* at 202-03. *See also NLRB v. Bell Aerospace*, 416 U.S. 267, 294 (1974). While the Commission has said little or nothing to explain why it is sensible to postpone these decisions to the stage of review of individual proposals, the necessity of its conducting that review seems to us, at this point, an adequate ground for deferring to its judgment.

This is not to say, however, that the Commission may endlessly postpone the necessary decisions. Failure to make the rule reasonably determinate by the time a pipeline starts Order No. 436 operations would severely constrain the Commission's authority to enforce the Order against the pipeline. Such failure would at least complicate actions seeking injunctive relief against pipelines under § 20 of the NGA, 15 U.S.C. § 717s (1982), and would probably make impossible any effort to secure penalties under § 21, 15 U.S.C. § 717t (1982). S*ee NLRB v. Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir. 1966) (Friendly, J.) ("the [judicial] hackles bristle still more when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known, or might even have been taken in express reliance on the standard previously established"). *Cf. Boyce Motor Lines, Inc. v. United States*, 342 U.S. 337, 340 (1952) (requirement of adequate

notice for criminal enforcement of administrative regulations). Moreover, if the Commission approves plans of compliance so vague that enforcement is impaired, its posture will be essentially that found fatally defective in *MPC II*: it will have authorized blanket certificate transportation under rules not adequately grappling with the potentially discriminatory effects.

The Commission's oracular procrastination (a blend of Delphi and Fabius) makes challenges to the specifics of "first come, first served" unripe. These challenges include assertions that the policy (1) gives inadequate attention to contractual commitments or to "dependency" as bases of distinction; (2) unduly threatens the security of supply of LDCs; and (3) disregards equities based on prior payments for pipeline capacity. *See, e.g.*, Brief of Interstate Pipeline Group at 35-36; Brief of Associated Gas Distributors at 39-41. One intervenor also poses a carefully reasoned attack on the Commission for its failure to consider alternatives such as an auction system. *See* Brief of Baltimore Gas & Elec. Co. at 19-20. Though the point is much closer, the Commission's vagueness and lack of commitment are such that even this attack appears unripe. The ripeness doctrine seeks to

> prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.

Abbott Laboratories v. Gardner, 387 U.S. 136, 148-49 (1967). As the Commission confined its disposition of the issue to some general remarks in its supporting statement, our involvement in the merits at this stage would defy these principles.

III. Rate Conditions

With the stated intention of imposing on pipelines more of the risk and responsibility for their own business decisions, the Commission has established a system of flexible rates. *See* 18 C.F.R. §§ 284.7, 284.8(d), 284.9(d).[10] Tariffs are to provide for ceilings and floors, with the pipeline free to charge anywhere within that band. Each maximum rate is to be based on what is typically known as "fully allocated cost," *i.e.*, a rate such that, if the pipeline carries projected volume at the specified unit price, it should exactly recover all costs allocable to the relevant service for the period. *See* 18 C.F.R. § 284.7(c)(3). Minimum rates are to be based on average variable cost. *See* 18 C.F.R. § 284.7(d)(4)(ii). The maximum rates are to vary depending on whether the service is in a peak or off-peak period, and on whether it is firm or interruptible service. A pipeline discounting any service from the maximum rate must, within 15 days of the close of the billing period, report the maximum rate for the transaction, the rate actually charged, the shipper's identity, and any corporate affiliation between pipeline and shipper. 18 C.F.R. § 284.7(d)(5)(iv).

Pipelines may charge a "reservation fee" for firm service. Otherwise shippers could request whatever volume they liked, without cost and regardless of intent to use. As requests would vastly exceed capacity, the pipeline could not rationally plan capacity allocation. *See* J.A. 457-60. Apart from the reservation fee, pipelines are required to charge on a "volumetric" basis, *i.e.*, a

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[10] These sections govern permissible rates for transportation by interstate pipelines under § 7 blanket certificates and under § 311. Rates charged by intrastate pipelines under § 311 are required to be "fair and equitable." *See* NGPA § 311(b)(2)(A), 15 U.S.C. § 3371(b)(2)(A) (1982); 18 C.F.R. §§ 271.101-.1106 (1985). Order No. 436 also requires intrastate pipelines to adhere to the restrictions on reservation fees that Order No. 436 imposes on interstate pipelines' transportation. *See* 18 C.F.R. § 284.123(b).

simple charge per unit actually transported, without a "demand charge" or "minimum bill."

A. *Absence of Finding that Prior Rates Were Unlawful.*

The Interstate Pipeline Group objects that the Commission did not make specific findings that any rates charged by individual pipelines were unlawful before imposing the new rate conditions. The Commission is not required to make individual findings, however, if it exercises its § 5 authority by means of a generic rule. *See, e.g., Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1165-68 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986). The pipelines seek to distinguish *Wisconsin Gas* on the ground that it "involved specific findings as to a single billing term," to wit, minimum bill provisions that included variable costs. (Minimum bills charge for specific portions of contract demand even as to gas that is not taken; the Commission believed that inclusion of variable costs in such bills imposed an unjustifiable restriction on customer choice of gas supply and improperly sheltered pipelines from competition.) The distinction is irrelevant. What justified the generic approach in *Wisconsin Gas* was the Commission's conclusion that *any* tariff violating the rule would have such adverse effects on the interstate gas market as to render it "unjust and unreasonable" within the meaning of § 5. That is precisely what the Commission has concluded here.

The pipelines may be claiming that the Commission's failure to adduce evidence meeting the standards of adjudication breaches the substantial evidence requirement of § 19 of the NGA, 15 U.S.C. § 717r (1982). Again *Wisconsin Gas* is dispositive. There the court reaffirmed the court's conclusion in *American Public Gas Ass'n v. FPC*, 567 F.2d 1016 (D.C. Cir. 1977), that § 19's reference to "substantial evidence" located as it is in the provision guiding judicial review, does not dictate the procedure to be employed in FERC's notice-and-comment rulemakings. *Wisconsin Gas*, 770 F.2d at 1167-68.

Finally, the pipelines' complaint may be that the Commission adopted its new rate criteria without "factual" submissions tracing a relationship between rate practices formerly permitted and the evils that it sought to correct. There may be circumstances in which such a claim would prevail. In *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511, 1514 (D.C. Cir. 1984), for example, this court declared that "mere reliance on an economic theory cannot substitute for substantial record evidence and the articulation of a rational basis for an agency's decision." In fact, however, the court in *Electricity Consumers* was persuaded that the Commission had "inexplicably distorted" the theory that it claimed to apply. *Id.* Here the pipelines point to no such inexplicable distortion.

Promulgation of generic rate criteria clearly involves the determination of policy goals or objectives, and the selection of means to achieve them. Courts reviewing an agency's selection of means are not entitled to insist on empirical data for every proposition on which the selection depends. *Wisconsin Gas* made that clear. For example, in the rulemaking proceeding parties had objected that curtailment of the minimum bill would result in the pipelines shifting costs to its most captive customers. The Commission responded in part with a prediction that "the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers." 770 F.2d at 1161. The court accepted this without record evidence, presumably because it viewed the prediction as at least likely enough to be within the Commission's authority. Clearly nothing in *Electricity Consumer's* reference to "economic theory" was intended to invalidate agency reliance on generic factual predictions merely because they are typically studied in the field called economics. Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that competition will normally lead to lower prices.

In support of this objection the pipelines do not identify any factual proposition, relied on by the Commission, that they regard as requiring additional support. Accordingly, the objection cannot succeed.

B. *Allowance of Discounting Generally.*

Several petitioners object that the Commission's allowing pipelines to discount from the maximum rates is in effect an approval of "undue preference[s]" and "undue discrimination" in violation of §§ 4 and 5 of the NGA. But "the mere fact of a rate disparity" is not enough to constitute unlawful discrimination. *Cities of Bethany v. FERC*, 727 F.2d 1131, 1139 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984). The reporting system will enable the Commission to monitor behavior and to act promptly when it or another party detects behavior arguably falling under the bans of §§ 4 and 5. This provision for flexibility conforms to Congress's intention in the NGA to allow a vital role for private contracting between the parties. *See United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 338-39 (1956); *see also Sea-Land Service, Inc. v. ICC*, 738 F.2d 1311, 1316-19 (D.C. Cir. 1984) (rejecting proposition that "contract rates," based on individual contract but available to similarly situated shippers of like commodities, are automatically violative of nondiscrimination principle). Accordingly, given the Commission's broad latitude to choose between rulemaking and adjudication, *see SEC v. Chenery Corp.*, 332 U.S. 194 (1947),[11] we could find the provisions illegal only if they carried such a risk of allowing undue discrimination or preferences as to be arbitrary and capricious. We do not find the risk so high.

The Associated Gas Distributors call our attention to the problem of discounts in favor of a pipeline's gas

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[11] *See also supra* part II.B.3.

trading affiliate. We recognize that such transactions may carry more than the usual risk of undue discrimination. *Cf.* NGPA § 601(b)(1)(E), 15 U.S.C. § 3431(b)(1)(E) (1982) (imposing a special limit on pipeline recovery of cost of gas purchased from affiliate). But we see no reason to think that such a discount should be *per se* unduly discriminatory. If a pipeline gives its gas trading affiliate discounts identical to those given to unaffiliated parties in identical circumstances, the discount would not be unlawful merely on account of the affiliation. Accordingly, the risk of such discounts proving invalid is insufficient to justify invalidation of the rule.

C. *Potential Discrimination Between Bundled and Unbundled Transportation.*

Other petitioners suggest that the Commission's rate regulations are invalid because they sanction undue discrimination between unbundled transportation and the transportation component of a bundled sales transaction. That the criteria governing permissible rates in the two categories are different, however, does not establish discrimination between them. Most notably, the petitioners point to no reason to suppose that, as a whole, unbundled transportation service will recover a lower proportion of its costs than will the transportation component of unbundled sales. Indeed, the rate provisions specify that the maximum rates for each subcategory of unbundled transportation are to be designed to recover "solely those costs which are properly allocated to the service to which the rate applies." 18 C.F.R. § 284.7(d)(4)(i). That the pipelines may offer discounts does not alter the case. They do so at their own risk, *see especially id.* at § 284.7(a)(5)(iii) (disallowing any rate seeking to recover losses from a prior period); pipeline managements will presumably aim at a pricing strategy that will, in fact, fully recover costs allocable to unbundled transportation. We cannot evaluate the rule on the basis of an assumption that they will not succeed. (We address below a claim

that the rate provisions disable pipelines from full recovery of unbundled transportation costs.)

The claim of discrimination in favor of unbundled transportation contains a more subtle argument (or at least the seeds of such an argument): even though such rates may recover exactly the cost of service (just as for the transportation component of sales service), perhaps the flexibility afforded pipelines will in effect give unbundled transportation an advantage over sales service. The possibility is hardly one that we may rule out *a priori*. But we think it a problem that the Commission should be free to solve if and when it develops. As the Commission points out, the historical problem has been that unbundled transportation rate provisions put it at a *disadvantage* as against sales service. J.A. 318. No one appears to dispute that finding. It seems wholly suitable for the Commission to experiment with one rate structure in this specialized area; if it proves a triumphant success, the Commission will doubtless have opportunities to extend it to sales.

D. *Selective as Opposed to Uniform Discounts.*

Some parties accept the concept of price discounting but argue that the Commission should allow only "uniform" discounting (in effect requiring a pipeline to promulgate in advance the criteria under which it would provide discounts). The Commission, however, made the judgment that such a rule would unduly stifle discounting. J.A. 478-83. It saw substantial gains from such discounts: cheaper fuel supplies for the price-elastic customers receiving the discounts; reduced revenue shortfalls for pipelines that would otherwise lose the business altogether; and protection for non-favored customers from rate increases that would ultimately occur if pipelines lost volume through inability to respond to competition. J.A. 483.

For much the same reasons that courts allow administrative agencies the leeway to choose between rulemaking and adjudication (variability of circumstances, difficulties of foresight), we think that the Commission was within its power to allow pipelines a parallel choice. But, just as courts insist on a degree of agency consistency, *see, e.g., Local 32, American Federation of Gov't Employees v. FLRA*, 774 F.2d 498, 502 (D.C. Cir. 1985), we expect that the Commission will exact from the pipelines as much consistency of application as is necessary for both to be in conformity with §§ 4 and 5.

E. *Consistency of "Value-of-Service" Discounting with MPC II.*

The American Public Gas Association and others contend that the general consent to selective discounting violates this court's decision in *Maryland People's Counsel v. FERC* (*"MPC II"*), 761 F.2d 780 (D.C. Cir. 1985). The attack is directed especially to Commission suggestions—in supporting statements, not the rule itself—that discounting intended to meet competition from alternative fuels or indeed from other pipelines is not *per se* unduly discriminatory. J.A. 476.

Petitioners misconceive the scope of *MPC II*. Pipelines were using their market power in the transportation market to discriminate (indirectly) in the sale of gas, a commodity that Congress had concluded was produced under roughly competitive conditions. In the sale of such a commodity there is no economic justification for charging different prices based on the purchasers' differing access to substitutes (*i.e.*, their price elasticity of demand). Indeed, if a product is produced under competitive conditions, such price discrimination cannot occur unless a bottleneck with market power stands between it and the customers. By contrast, pipeline transportation service is marked by a degree of natural monopoly, J.A. 305-06, 352, 481 (*i.e.*, longrun average costs decline in the

relevant range of production). *See* 2 A. Kahn, *The Economics of Regulation: Principles and Institutions* 119-23 (1971). In such an industry, "value-of-service" ratemaking (*i.e.*, rates varying on the basis of differing demand characteristics) has an established place,[12] though not an uncontested one.[13] The equitable argument in favor of such differentials is that they may benefit captive customers by making a contribution to fixed costs that otherwise would not be made at all. (The efficiency argument is that such differentials will raise total volume closer to the level it would attain if all sales were priced at marginal cost.)

These justifications were missing in *MPC II*. There the court found that the then-existing blanket certificate regulations allowed pipelines to deny captive consumers access to the spot market for gas while providing it for the non-captives. 761 F.2d at 788. This allowed pipelines to preserve the revenues attributable to transportation of gas to fuel-switchable customers, while continuing to sell their inventory of overpriced gas to captive customers. The Commission advanced an argument that the pipelines'

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[12] *See* E. Gellhorn & R. Pierce, *Regulated Industries* 185-89 (1987).

[13] *See* Tye & Leonard, *On the Problems of Applying Ramsey Pricing to the Railroad Industry with Uncertain Demand Elasticities*, 17A Transportation Research 439 (1983); Tye, *Ramsey Pricing and Market Dominance Under the Staggers Rail Act of 1980*, 24 Transportation Research Forum 667 (1983); Meyer & Tye, Toward Achieving Workable Competition in Industries Undergoing a Transition to Deregulation (March 19, 1987) (unpublished). We do not understand these critics to attack rate differentials where application of some apparently egalitarian principle, such as an equal revenue-to-variable-cost ratio, would result in prices for some customers or commodities above what the profit-maximizing monopolist would charge. *See* Tye, *Ramsey Pricing and Market Dominance Under the Staggers Rail Act of 1980*, 24 Transportation Research Forum at 669-70; Henderson, *Price, Discrimination Limits in Relation to the Death Spiral*, 7 Energy Journal (No. 3) 33, 37 (1986).

receipt of transportation revenues would redound to the benefit of captive customers—an argument that sounds like the one advanced above. The court said no. First, we said that the Commission had offered no reason to think that the captives could not enjoy the fuel switchables' contribution to fixed costs even if the Commission conditioned the program on equal access for captive consumers—precisely what the Commission has done here. *Id.* Second, we pointed out that the Commission had nowhere answered the petitioners' argument that the captives' loss through lack of access to the wellhead market would greatly exceed their gain through the fuel-switchables' contribution to fixed costs. *Id.* Here, of course, the Commission is providing access to the spot market. Thus the facts here obviate our two reasons for rejecting the Commission's argument on contributions to fixed costs.

To read *MPC II* as a rule that price differentials based on demand conditions are always unduly discriminatory would render the decision a defiant and unreasoned exception to the general pattern. The judicial acceptance of such price differentials is longstanding. For nearly 100 years, for example, the courts have interpreted the anti-discrimination provisions of the Interstate Commerce Act to allow the ICC to approve differentials justified exclusively by competition. *See, e.g., Texas & Pacific Ry. v. ICC*, 162 U.S. 197, 218-19 (1896); *Dresser Industries, Inc. v. ICC*, 714 F.2d 588 (5th Cir. 1983) (review under three different anti-discrimination provisions); *National Gypsum Co. v. United States*, 353 F. Supp. 941, 946-49 (W.D.N.Y. 1973) (enumerating cases following this view). Indeed, the Supreme Court has even struck down an ICC finding of unlawful discrimination where it appeared to be based on an absolute rule that competitive conditions could never justify a rate differential. *Eastern-Central Motor Carriers Ass'n v. United States*, 321 U.S. 194 (1944).

We have answered the claims that the rate provisions of Order No. 436 put it in violation of our mandate in *MPC II*. This is not to say, of course, that the Commission is free to uphold every price distinction based on different demand elasticities. It has long been contended, for example, that rate differentials based exclusively on competition between transporters with similar cost functions may end up forcing captive customers to bear disproportionate shares of fixed costs without any offsetting gain in efficiency. *See, e.g.*, 1 A. Kahn, *The Economics of Regulation: Principles and Institutions* 159-81, esp. 170 (1970). The contention is not self-evidently true: if the demand of buyers with access to competing carriers is at all price elastic, the price reductions they enjoy will raise their demand close to competitive levels. In any event, the Commission may properly defer its ultimate resolution of these issues to another day and another proceeding. *Cf. American Commercial Lines, Inc. v. Louisville & Nashville R.R.*, 392 U.S. 571 (1968) (finding broad discretion in ICC to choose format in which to resolve issues of price discounting in competition between railroads and barge-truck combinations).

F. *Impact of Discounting on Pipeline Solvency.*

Petitioners ANR Pipeline Company and Colorado Interstate Gas Company fault the regulations for allowing the pipeline to discount below the ceilings but never to charge more. To the Commission's defense that the discounting mirrors the world of unregulated firms, they respond that in such a world the circumstances where market conditions force a firm to discount are likely to be matched by ones allowing the charge of a premium. (In equilibrium firms will earn a normal profit.) Here, they argue, the rules parallel only the downside of the unregulated market. As a result, they say, return will necessarily be less than in other industries with corresponding risks, in violation of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

We can imagine a rate methodology under which this contention would be sound. Suppose that a pipeline has a capacity for transporting 120,000 units a year, that each year's share of fixed costs amounts to $90,000, and that variable costs are $.10 per unit. In an initial rate case, the Commission projects volume at 100,000 units, and thus sets a maximum price of $1.00 per unit ($.90 as a share of fixed costs and $.10 for variable costs).

While those rates are in effect, suppose the firm in fact carries 100,000 units at $1.00, but, spotting market opportunities, carries another 10,000 units at $.20 per unit for customers who would switch to alternative fuels if the transportation charge rose above $.25 per unit. (If the pipeline knew that $.25 was the switchover point, it would charge that, but it may not know exactly.)

In the next rate case, suppose the Commission projects use at 110,000 units, and accordingly sets the maximum price at $.92 per unit ($.10 for variable costs and $.82 ($90,000/110,000) for fixed costs). Such a rate would be sufficient to recover costs only if the pipeline carried 110,000 at the maximum rate; but the evidence overwhelmingly suggests that it will not be able to do so—the extra 10,000 units of business were due to the discount. Unless some change in circumstances saves the pipeline, revenue will be $94,000 ($92,000 for 100,000 units transported at the maximum rate plus $2,000 for 10,000 units at $.20), against costs of $101,000 ($90,000 fixed and $11,0000 variable).

We see no reason, however, to suppose that the Commission intends such calculations. Its only statement relating to projections, 18 C.F.R. § 284.7(c)(3), indicates the contrary:

> The pipeline's revenue requirement allocated to firm and interruptible services should be attained by providing the projected units of service in peak and off-peak periods at the maximum rate for each service.

In its commentary, the Commission pointed to this passage as proof of its agreement with MPC's suggestion that "revenue projections in rate filings [should] assume that all sales and transportation volumes will be charged at the maximum rate." J.A. 484. Thus, it appears that "rate" in § 284.7(c)(3) refers to the maximum unit price, not to projected throughput. This would appear to undermine any fear that the Commission might employ the dubious procedure hypothesized above.

* * * *

Thus we find no legal defect in the rate provisions of Order No. 436.

IV. Contract Demand ("CD") Adjustment

Local distribution companies require a firm supply of gas. Typically they have looked to pipeline sales service to fill this need. Firm sales contracts give the customer the right to demand, and obligate the pipeline at all times to stand ready to deliver, a certain quantity of gas per day, generally known in the industry as "Contract Demand" or "CD." Once the arrangement receives the necessary certificate under § 7 of the NGA, the LDC's entitlement and the pipeline's obligation acquire a legal existence independent of the contract and persist until the Commission issues formal approval of "abandonment." *See California v. Southland Royalty Co.*, 436 U.S. 519 (1978); *Panhandle Eastern Pipe Line Co. v. Michigan Consolidated Gas Co.*, 177 F.2d 942, 945 (6th Cir. 1949). For a "full requirements" customer, relying on a single pipeline, the CD will amount to its entire anticipated gas needs; "partial requirements" customers, as the name suggests, rely on more than one pipeline.

"Demand charges" are based on CD and are payable regardless of the customer's actual use; having thus committed itself to partial payment for the gas covered by its CD, a customer pays only a "commodity charge" when

it actually takes gas.[14] Thus, if the demand charge is $1 and the commodity charge $3, the customer will switch to an alternative supply only when the alternative's total cost (transportation and gas) is under $3, even though (in a sense) gas at $3.50 would be a better bargain. (It is better only "in a sense" because the customer gets a security of supply from its pipeline supplier that it does not get in the spot market.) The relation with a regular pipeline supplier thereby constrains the customer's practical freedom to take advantage of open access to the wellhead market. The higher the CD in relation to its total usage, and the higher the demand charge as a proportion of total price, the more severe is the constraint.

To make the customers' access meaningful, Order No. 436 provides customers a limited right to unilaterally modify their contracts with pipelines who elect to operate under the Order. It entitles any party with a firm sales contract on the date the pipeline becomes subject to Order No. 436[15] to (a) convert specified percentages of its CD from gas purchase (*i.e.*, fully bundled service) to unbundled gas transportation or (b) reduce its CD by the same percentages.

The entitlement to convert or reduce[16] is 15% for each of the first and second years, 20% for the third year, and

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[14] Order No. 436 largely retains this two-tiered rate structure, with firm transportation customers paying a "reservation" fee for the guaranteed right to call on a certain amount of the pipeline's capacity and a "volumetric" fee to cover the variable cost of providing the service actually called for. *See supra* part III.

[15] A pipeline becomes subject to the provisions of Order No. 436 for these purposes when it accepts a blanket certificate, provides service under the § 311 regulations after a certain date, or commences or continues transportation of OCS gas under a blanket certificate. 18 C.F.R. § 284.10.

[16] A customer may elect both to convert and to reduce, but the total adjustment to CD cannot exceed the customer's accrued entitlement. 18 C.F.R. § 284.10(e).

25% for each of the fourth and fifth years. The entitlements are cumulative. For example, a firm customer could reduce contract demand not at all in the first two years and then reduce by 50% in the third year. Or it could refrain from exercising the option at all in the first four years, and then reduce by 100% in the fifth year or any year thereafter. *See* Order 436-C, J.A. 1355-60.

Petitioners attack the Commission's CD adjustment program on several fronts. A number of pipelines assert that the conditions violate the rule of *Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980), restricting the use of the Commission's power to impose conditions on certificates issued under § 7. In addition, the pipelines attack the sufficiency of the Commission's reasoning for adopting CD conversion and CD reduction. With respect to CD reduction a number of LDCs lend their voices to the attack. Finally, Maryland People's Counsel contends that this court's opinion in *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (*"MPC III"*), compels the Commission to permit customers to convert 100% of their CD to transportation immediately.

A. *Legal Authority.*

1. *Violation of Panhandle doctrine.*

Several pipelines contend that the Commission's creation of the CD conversion/reduction options violates the principle established by this court in *Panhandle*, *supra*. Panhandle had applied for certification under § 7(c) of new transportation service to an industrial gas user. Exercising its § 7(e) authority to attach "such reasonable terms and conditions as the public convenience and necessity may require," the Commission approved the certification subject to a condition requiring Panhandle to "flow" the resulting revenues through to its wholesale gas customers. The condition effectively gave the latter a rate reduction equal to the new revenues. The Commission's

theory was that the wholesale gas customers had already paid for the capacity used to provide the service to the industrial user (or had obligated themselves to do so under existing rates). 613 F.2d at 1123. This court held, however, that such a use of the Commission's § 7 conditioning authority was an illegal circumvention of § 5. The latter authorizes the Commission to modify pipeline rates and charges when it finds them "unjust, unreasonable, unduly discriminatory, or preferential," but only after notice and hearing in which, it is well established, the Commission bears the burden of proof. *See, e.g., Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 184 (D.C. Cir. 1986).

In the present case, the Commission's creation of the CD conversion/reduction option similarly modifies previously approved arrangements that are separate from the transportation authority that a pipeline would seek under Order No. 436. On its face, it appears to challenge *Panhandle*'s strictures against extensions of the § 7(e) conditioning power that would erode substantive or procedural limits on the Comission's power.

The Commission has taken high ground, which we think quite untenable. It argues that since application for a blanket certificate under § 7 is entirely voluntary, there is no need for it to point to any express congressional grant of power. It asserts that in the CD modification conditions it was "*not requiring* the adjustment of previously-certificated service. . . ." FERC Brief at 107 n.1 (emphasis added). Obviously the suggestion that *Panhandle* presents no problem because the application for certification is voluntary is unacceptable. As all § 7 applications are voluntary in a legal sense, the Commission's theory would extirpate the *Panhandle* doctrine.

Apart from the voluntariness theory, the Commission notes that it has invoked § 7(b), authorizing it to permit natural gas companies to abandon certificated service. In 18 C.F.R. § 284.10(f)(3) it expressly finds that pipe-

line abandonments of service, pursuant to customer elections under the Order, are "permitted by the present or future public convenience and necessity." But this finding looks only to the pipeline's obligation, as is fitting under § 7(b). Neither that section nor the finding thereunder supports the Commission's relieving customers of their contract obligations.

For that, it appears one must turn to § 5 of the NGA, which allows the Commission to set aside any unjust, unreasonably or unduly discriminatory "contract affecting" rates and charges. Much of the Commission's reasoning suggests a belief that under present circumstances inflexible CDs in fact qualify as "unjust, unreasonable, [or] unduly discriminatory" terms. But the Commission has expressly declined to rely on § 5, and has not explained why not. J.A. 1059.

The "voluntariness" theory and the invocation of § 7 (b) appearing inadequate, and the Commission having disclaimed reliance on any other provision (notably § 5), the CD modifications are without basis in law insofar as they condition blanket certificate transportation under the NGA on release of customers from contract obligations. (Immediately below we address the issue of transportation under § 311.) On remand, the Commission can proceed under such grants of power as it believes are relevant undistracted by the notion that its power under § 7(e) entitles it to sweep aside the substantive and procedural constraints of the NGA. In so doing, of course it may employ rulemaking. *Cf. Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986).

CP National and other LDCs contend that the Commission is without authority to impose the CD conversion/reduction option as a condition of authority to transport under § 311 of the NGPA. No analysis is offered in support of the claim. The premises of the *Panhandle* doctrine are absent here. Perhaps because of its expectation

that § 311 would operate simply to forge interstitial links between the hitherto separate interstate and intrastate markets, *see Public Service Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342 (1983); *Process Gas Consumers Group v. United States Dep't of Agric.*, 694 F.2d 728, 764 (D.C. Cir. 1981) (other portions vacated and reconsidered *en banc*, 694 F.2d 778 (D.C. Cir. 1982)), *cert. denied*, 461 U.S. 905 (1983), Congress never created for § 311 transportation any elaborate structure paralleling that of the NGA. This claim fails.

In summary, the Commission has failed to ground the CD adjustment provisions in any adequate section of the NGA. Because the conditions can legally apply to § 311 transportation, however, and because we have no reason to expect that the Commission's interest in attaching the options to § 7 transportation has waned, we proceed to address a number of other attacks.

2. *Alleged lack of compliance with § 7(b).*

As noted above, the Commission has, in the CD modification provisions, identified circumstances under which pipelines are automatically entitled to abandonment of service—namely, when the customer exercises the election provided. In support of this it has made the necessary finding under § 7(b) that such abandonment serves the "public convenience or necessity." [17] CP National and others fault the Commission for failing to make various specific findings said to be subsidiary parts of that conclusion. They cite, for example, *Transcontinental Gas Pipe Line Corp. v. FPC*, 488 F.2d 1325, 1329-30 (D.C. Cir.

[17] We see no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment (*i.e.*, establish a system of "pre-granted" abandonment approval). *Cf. Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986) (approving modification of tariffs in a generic § 5 proceeding).

1973), *cert. denied*, 417 U.S. 921 (1974), overturning the Commission's decision to permit certain producers to abandon sales to an interstate pipeline. In that context, the court held that the Commission must study various factors and make a "broadly conceived comparison of the needs of the two natural gas systems [the current purchaser and the producers' intended substitute] and the public markets they serve." *Id.* at 1330 (footnote omitted).

The petitioners implicitly assert that the substantive ingredients of the "public convenience or necessity" are the same regardless of the type of abandonment. This makes no sense. Clearly the substantive concerns relevant to terminations at the option of LDCs are altogether different from those relating to producers' abandonment of their sales to pipelines in a period of acute shortage, as was the case in *Transcontinental.*

Elizabethtown Gas Company derives from *Transcontinental* the proposition that the Commission cannot wholly defer to private parties' choice. *Id.* at 1328-29. We see no conflict between that precept and the Commission's action here: nothing in *Transcontinental* prevents the Commission from identifying circumstances which, when coupled with the purchaser's election, satisfy the public convenience and necessity.

B. *Adequacy of the Commission's Reasoning in Support of CD Conversion.*

Pipelines attack CD conversion as arbitrary and capricious, focusing mainly on its impact on preexisting supply arrangements. They entered into these arrangements primarily in response to their Commission-imposed obligations to maintain sources of supply adequate to meet their sales commitments,[18] *see* 18 C.F.R. § 2.61, and

[18] In some cases these commitments were not freely entered into, but are the product of Commission orders under NGA § 7(a) that the pipeline extend service to a particular customer.

in reliance on their ability to recoup the costs through firm sales contracts. The arrangements consist largely of long-term supply contracts with producers, but also include investments in expensive facilities for the importation of liquefied natural gas ("LNG"), *see Trunkline LNG Co. (Opinion No. 796)*, 58 F.P.C. 726 (1977); *Trunkline LNG Co. (Opinion No. 796-A)*, 58 F.P.C. 2935 1977).[19] In addition to arguing that the rule defeats their justifiable reliance on their sales contracts, the pipelines argue that the Order is shortsighted: seeing their treatment in this situation, pipelines will hardly jump to meet any future shortage or come to the assistance of a converting LDC that later finds itself in trouble when the market tightens.

An assertion that agency conduct was arbitrary and capricious requires the court to explore the links between that conduct and the agency's statutory authority. We must examine the agency's reasoning to determine whether its considered the relevant factors and drew "a 'rational connection between the facts found and the choice made.' " *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962)). Here we are hampered because, insofar as the Commission has attached the CD conditions to § 7 blanket certificate transportation, its asserted statutory basis, § 7(e), is legally insufficient. *See supra* part IV.A.1. However, in attaching the condition to § 311

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[19] Panhandle and Trunkline seek to supplement the reliance argument by noting that the investments were made on the assumption that "rolled-in" pricing (*i.e.*, charges by pipelines based on average gas cost rather than marginal cost) would enable the pipelines to recover the costs. The Commission approved the investments, and in doing so acknowledged that average pricing was essential to cost recovery: no customer would buy the LNG at its full price. *Opinion No. 796-A*, 58 F.P.C. at 2940. The point does not enhance their claim; rolled-in pricing remains. The pipelines' problem is that even when prices are rolled in, their embedded contract costs for gas exceed what the current market will bear.

transportation, the Commission plainly invokes the authority of § 311(c), which allows it to prescribe "terms and conditions." Section 311 itself states no explicit standards for the exercise of the power, but the overall purposes of the NGPA provide a standard—somewhat amorphous to be sure—against which we can and must measure the Commission's decision. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968). Given the overlap in the purposes of the NGA and the NGPA this process will have implications for possible future exercises of the Commission's NGA authority, presumably § 5, but in view of the Commission's disclaimer of reliance on § 5, our analysis does not directly apply to such an exercise.

Unilateral abrogation of a contract is an extreme measure. This is true even where the abrogation is partial, as it is under the conversion option, and even though common law doctrines of impracticability and impossibility shift the risk allocation nominally arrived at by the parties. (They may well do so only to arrive at the allocation the parties would have made had they considered in advance the risk that eventuated. Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. Legal. Stud. 83 (1977).) Nonetheless, we find the reasoning underlying CD conversion persuasive.

Unlike the typical contract, those at issue here necessarily reflect the pipelines' monopoly power. The Commission found the transportation network "highly monopolistic in some markets, fairly competitive in others." J.A. 281. Historically, in fact, many customers have been served by only one pipeline. J.A. 279. This is not disputed. Until the recent partial unbundling of pipeline sales and transportation service, the pipelines were the only parties from whom LDCs might practicably buy gas. Once the unbundling of services began, the LDCs' position changed little, as the pipelines wielded their monopoly

power over transportation to deny them the ability to purchase from would-be competing suppliers. J.A. 318, 352 (finding practice "unduly discriminatory and preferential"). Absent these market restraints, there is no reason to believe that the LDCs would have agreed to the long-term sales contracts binding them to pay rates based on the pipelines' costs, whatever those might be.[20] Yet, by virtue of these arrangements, the LDCs found themselves denied access to the spot market, which offers prices at least 20% below the pipelines' average gas costs.[21] *See supra* part I.

FERC thus found that to remedy these effects, it was essential to permit limited LDC abrogation of pipeline sales contracts:

> The transitional contract demand reduction and conversion options are essential if the goal of nondiscriminatory access to transportation is to be achieved . . . . With such an option, full-requirements customers—especially small, sole-supplied local distribution companies . . .—will have access to competitively-priced supplies of the gas commodity.

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[20] The Commission rightly acknowledged that the circumstances justifying the extraordinary remedy of unilateral contract adjustment were transitional. It afforded the conversion right only to firm sales customers on the date a pipeline becomes subject to Order No. 436. 18 C.F.R. § 284.10(b); J.A. 440-41. Any customer entering into a sales agreement thereafter will have had the option of nondiscriminatory access by virtue of Order No. 436; accordingly, it will be held to such a commitment. *See id.*

[21] The spot market is, of course, not adequate as an exclusive source of gas for an intermediary selling to non-fuel-switchable consumers. But even a price of $2.50 for gas under long-term contracts (the price available as of mid-1986, *see supra* part I) would represent a saving over the pipelines' embedded contract price. The latter includes not merely the average price being paid by pipelines at the wellhead (about $2.50 as of mid-1986, accordingly to FERC, *see supra* part I), but also the build-up in take-or-pay liability deriving from reduced takes of higher-priced gas.

> Thus, they will no longer be dependent on a single merchant for their gas supplies. . . .

J.A. 407-08. *See also* J.A. 424 ("only through conversions can sole-supplied customers have access . . . to the national market"). Failing to provide such an option, FERC concluded, would be "to condone the fundamental form of undue discrimination by monopoly power which the NGA intended to prohibit." J.A. 426.

Thus while the CD conversion option partially denies pipelines the benefits of their contracts, it does so only because those contracts are vestiges of their monopoly power, and only in order to correct the consequences of that power. This action therefore conforms to the purposes of the NGPA. In *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709 (1986), the Supreme Court declared that enactment of the NGPA left as the "aim of federal regulation . . . to assume adequate supplies of natural gas at fair prices," *id.* at 716, and referred to Congress's "determination that the supply, the demand, and the price of high-cost gas [the type at issue there] be determined by market forces," *id.* at 716-17. Congress's continued concern for the market power of pipelines is expressly reflected in NGPA § 601 (b)(1)(E), providing that the price of gas purchased by a pipeline at the wellhead from its affiliate is deemed just and reasonable only to the extent that it does not exceed independents' prices in comparable sales.

Thus it would appear that the Commission has been correct in its belief that under § 311 it should assert "the traditional regulatory approach in areas where it is needed to protect the public from market dominance by natural gas companies." J.A. 271. Provision of the CD conversion option for customers of pipelines offering § 311 transportation properly implements that view. Any principle quashing the Commission's chosen remedy would seem to block pro-competitive regulatory reform and run counter to a long judicial tradition favoring agency devel-

opment of whatever pro-competitive policies are consistent with the agency's enabling act. *See, e.g., Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 760 (1973); *Denver & Rio Grande W.R.R. Co. v. United States*, 387 U.S. 485, 492-93 (1967).

CD conversion may to a degree shift the costs of overpriced gas and take-or-pay liability to those pipeline customers least able to switch to reliance on the wellhead market. But circumstances limit the pipelines' power to shift the costs. Any customer of a pipeline electing to provide transportation under Order No. 436 has, by definition, the power to go out into the market to secure gas and unbundled transportation. That strategy has its costs—including, of course, the management costs of negotiating and coordinating long-term supplies, or fees to brokers for doing so. But these costs form the ceiling on what pipelines may charge. Accordingly we see no basis for rejecting FERC's conclusion that the cost-shifting risk was tolerable.

We accept FERC's conclusion that the relevant factors under § 311 tilt in favor of the CD conversion option.

C. *Adequacy of the Commission's Reasoning in Support of CD Reduction.*

Several LDCs attack the Commission's authorization of CD *reduction*. They contend primarily that it failed to meet the "substantial evidence" requirements of § 19(b) of the NGA and § 506(a)(4) of the NGPA, which are understood by the parties to be equivalent, in the rule-making context, to the "arbitrary and capricious" standard. *See Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1156 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986); *Mid-Tex Elec. Coop. Inc. v. FERC*, 773 F.2d 327, 338 (D.C. Cir. 1985). This standard requires the agency to "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs.*

Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

We agree with the challengers that the Commission has failed to develop an adequate rationale in support of CD reduction. Review of the Order on this point is considerably hampered by the Commission's tendency to wrap its justification for CD reduction together with the case for CD conversion. The two almost always appear together, like Rosenkranz and Guildenstern, making it hard to extract the portion of the argument that has any real connection with reduction. This is understandable in terms of the proposals' history. In the NOPR, the Commission offered CD reduction as the sole device by which customers could escape their long-term contracts with pipelines. When the Commission later recognized and embraced CD conversion, its analysis of CD reduction became largely obsolete. Yet it has continued in places to justify it as necessary to effect the goal of providing consumers access to competitively priced gas. *E.g.*, J.A. 407-08. *See also* J.A. 1055-58. If CD conversion is available, however, this justification fails. Below we review various other purposes asserted by FERC, as well as its treatment of the cost-shifting consequences of CD reduction.

(a) FERC argues that "[t]he transitional contract demand reduction and conversion options are essential if the goal of non-discriminatory access to transportation is to be achieved when pipelines operate under the new transportation rules." J.A. 407. In a later passage, rejecting a proposal that it afford only CD conversion, the Commission reasoned that a CD option limited in such a way would restrict customers' access to "transportation services on the same pipeline" and deny them the ability to shop around for unused transportation capacity booked on other pipelines. J.A. 448.

As justifications for CD reduction, these arguments seem peripheral to the problem the Commission set out to

solve in this rulemaking: access to gas competitively priced at the wellhead. CD reduction would of course help each LDC secure access to all the different producing areas of the country, in addition to the ones from which its existing pipeline supplier(s) draw their gas. But the record contains no suggestion that competitive wellhead prices are subject to important regional variations. While easy LDC access to all producing regions would help correct or prevent regional price variations, the Commission makes no argument that any such variations pose so great a problem as to require such drastic action as 100% CD reduction.

Of course, competition among pipelines in transportation services may well be expected to engender lower prices (at any given level of service quality). If so, it would fulfill the general consumer-benefit purposes of the Order. But the Commission does not spell out any such arguments. Moreover, any analysis along these lines would trigger attempted rebuttals, essentially based on the view that in a monopolistic or oligopolistic industry unrestricted consumer choice may lead to duplication of capacity and higher costs for consumers. Without assessing the validity of those arguments or the Commission's authority to adopt rules moving the industry towards more competition in transportation, we simply cannot find any Commission effort to justify CD reduction in such terms.

(b) The Commission argues that the levels of sales service that customers have contracted for on a firm basis "may no longer correspond to what they desire to purchase." J.A. 406 (footnote omitted). The Commission found that this imbalance between actual needs and contracted-for capacity has caused at least two problems. First, the discrepancy results in an undesirable inequity as "on some systems, interruptible transportation is *as a practical matter* virtually the same quality of service as firm," though available at lower rates. *Id.* (emphasis

in original). Second, the discrepancy also has the effect of unnecessarily denying firm service to some potential users, making the reduction option necessary "to allow a freeing up of firm capacity." J.A. 411. *See also* J.A. 417.

While the argument seems highly relevant to CD reduction, it hardly supports the broad remedy adopted. Even in its terms, it refers to a limited portion of the industry. The finding's lack of general application is underscored by the Commission's observations that most firm sales customers need their full contract demand on peak days. J.A. 420. If so, then the obsolescence referred to is clearly far from universal. If such obsolete certificates exist only "on some systems," it is unclear why the Commission believes that an industry-wide solution is needed, especially one that permits *all* LDCs—or rather, all LDCs in their relations with pipelines opting to offer service under Order No. 436—a right to reduce contract demand 100%.

The Commission argues that *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986), allows it to make § 5 determinations generically. J.A. 412. True but irrelevant. Neither *Wisconsin Gas* nor any other case of which we are aware supports an industry-wide solution for a problem that exists only in isolated pockets. In such a case, the disproportion of remedy to ailment would, at least at some point, become arbitrary and capricious. This is not to say, of course, that the Commission could not use generic rules to identify a limited class of LDCs to be entitled to reduce CD when special conditions are present. But here the Commission has said nothing to link the asserted obsolescence of CD levels to the broad class of purchasers made eligible.

(c) Responding to the complaints of some LDCs that the CD reduction option will force them to bear an additional share of pipelines' capital costs (*i.e.*, the costs now

borne by the customers that will exercise the option), the Commission asserts that customers are likely to seek little net CD reduction. J.A. 420. Accordingly there will be little net change, nationwide, in aggregate recovery of costs. *Id.*

The improbability of major *aggregate* cost-shifting, however, provides little answer to the concerns of captive customers of pipelines that are likely to lose out in the competitive race. While the Commission might justify the loss of such a captive by reference to potential aggregate gains, it has neither confronted the problem nor developed in any detail its reasons to expect the net gains.

D. *Insufficiency Under MPC III.*

Maryland People's Counsel argues that under the principle established in *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) ("*MPC III*"), the Commission was required to afford firm customer an *immediate* option to convert any purchase obligation *completely*.[22] We find the claim unpersuasive.

In *MPC III* this court addressed the validity of certain "special marketing programs" ("SMPs"), successors to the SMPs held invalid in *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) ("*MPC I*"). The SMPs reviewed in *MPC I* authorized the following approach to the mounting problem of high gas subject to high take-or-pay burdens: A producer would resell, at market rates, high-cost gas previously committed to a pipeline. A limited class of persons was eligible to purchase, and that class excluded captive consumers. The producer would credit the pipeline's take-or-pay liability for the sale, and the pipeline would transport the gas to the new purchaser. This court held the program invalid because it excluded captive consumers from the class of

[22] MPC does not challenge the phase-in of CD reduction.

eligible new purchasers, without adequate consideration of possible anti-competitive and anti-consumer consequences. FERC then amended the program to permit anyone with a firm contractual entitlement to purchase a pipeline's gas to nominate up to 10% of its contract demand to be purchased under the SMP. Thus the second-generation SMPs gave "captive" customers access to gas at competitive wellhead prices, but only up to the 10% figure. This court overturned the second-generation SMPs, finding them to be "of a piece with" the first. *MPC III*, 768 F.2d at 455.

We think that MPC finds more in *MPC III* than it contains. The Commission there made no effort to justify the 10% option in the second-generation SMPs by reference to classical "grandfathering" values. Here, by contrast, it invokes those values emphatically and we think plausibly, arguing that the pipelines require time to adjust to the new dispensation, particularly to resolve the take-or-pay problems presented by the producer-pipeline contracts. J.A. 1152. The specific phase-in period and percentages and election procedures resulted from detailed consideration of various options.[23] *See* J.A. 1145-55. In the event that the Commission modifies its disposition of the producer-pipeline contracts in light of our treatment of the take-or-pay issue or for any other reason, however, the Commission may wish to reconsider the phase-in of the conversion option.

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[23] We note that the Commission never explicitly responded to the proposals by the Department of Public Service of the State of New York that LDCs be required to give notice of their future gas purchase plans, with some sort of sanctions for deviation from projections. The Commission may have believed that its discussion of the need for customer flexibility addressed this issue. Arguably it did; the cursory response in FERC's brief did not address the issue of what the Commission had considered in the rulemaking (as opposed to what counsel later thought). FERC Brief at 104-05 n.1. On remand explicit consideration of the suggestion would eliminate a potential problem.

V. Producer-Pipeline Contracts

As noted above, certain contracts entered into by producers and pipelines between 1977 and 1982 have been at the root of the Commission's endeavor in Order No. 436. These problem contracts provide for prices far in excess of current market levels. They contain take-or-pay clauses requiring the pipelines either to purchase a specified percentage of the producer's deliverable gas or to make "prepayments" for that percentage anyway. The contracts typically permit the buyer to recoup prepayments by applying those amounts to subsequent "takes" of gas occurring within a limited period after prepayment. *See* 18 C.F.R. § 154.103 (mandating that purchase contracts for gas to be transported in interstate commerce carry a minimum five-year make-up period).

Although all parties refer to the problem posed by these contracts as the issue of take-or-pay, it is the combination of high prices with take-or-pay clauses that causes the difficulty. A 100% take-or-pay contract for gas priced at $1.00 per Mcf would usually cause the purchaser no trouble; gas purchased at the wellhead for $5.00 per Mcf, however, cannot be resold at that price (plus normal transportation mark-ups).

Between 1977 and 1982 the pipelines "rolled in" high-priced gas with low-priced gas (the latter largely due to wellhead ceilings imposed under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)), selling at an average price that was competitive with alternative fuels. But drops in the price of the latter exposed the pipelines to intense market pressure. This was soon reflected in reductions in the wellhead price for newly available gas (*i.e.*, gas not hitherto subject to contract). Pipelines reduced their takes of high-priced gas, and in 1983 prepayment liabiliites for the period between 1982 and 1985 were predicted to reach $7 billion. J.A. 301 & n.34.

At the heart of the industry's immediate problem is the discrepancy between the average cost of gas that pipelines have under contract and the much lower price of gas now available at the wellhead. The essence of that discrepancy is the same whether the pipelines buy overpriced gas and sell it at a loss, or decline to buy such gas and thereby incur take-or-pay liabilities. The price discrepancy represents a sunk loss of billions of dollars (doubtless reflected in actual drilling expenses). At issue among the parties is who should bear it. All actors in the natural gas industry—producers, pipelines, LDCs and consumers—are candidates for this dismal position. There is one exception: fuel-switchable users, who can employ the cheapest fuel competing with gas and thus cannot be induced to pay more than the current competitive price.

By enabling pipeline customers (and some end users) to obtain gas at current wellhead prices and thus escape the supra-competitive contract prices, Order No. 436 appears to relieve consumers from the threat. Conversely, it heightens the likelihood that pipelines will play the fall guys. Considered in this section of the opinion is whether FERC's lack of direct action as to the uneconomic contracts is permissible, particularly in light of Order No. 436's shift in the balance of forces.

A. *The Commission's Prior Activity and Its Inactivity in This Proceeding.*

In April 1985, shortly before issuing the Notice of Proposed Rulemaking (the "NOPR") that culminated in Order No. 436, the Commission issued a policy statement on the regulatory treatment that it would give payments made by pipelines to extinguish take-or-pay liabilities (referred to as "buy-out" payments). *Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations*, 50 Fed. Reg. 16,076 (1985) (codified at 18 C.F.R. § 2.76). The policy statment provides: (a) take-or-pay buy-out payments are not counted

toward NGPA price ceilings (*i.e.*, contracts to buy gas at NGPA ceilings do not breach the ceilings when the pipeline pays the producer in exchange for relief from take-or-pay obligations); (b) pipelines may file to include buy-out payments in their rate bases; (c) the method of cost recovery and the allocation among customers will be determined on a case-specific basis; (d) customers will maintain their NGA § 4 right to question the prudence and apportionment of buy-out payments; and (e) where the take-or-pay buy-out covers "jurisdictional" gas,[24] FERC will handle requests for the certificate amendments or abandonments terminating the producer's legal obligation with respect to such gas on an expedited basis.

Subsection (a) removes one potential difficulty to take-or-pay settlement (the price ceiling issue) and subsection (b) holds out to the pipeline the possibility of recovering the cost. Subsection (e) promises a reduction in red tape. Otherwise the policy is pretty noncommittal, and, more important, does nothing whatever to prevent the cost from flowing downstream to consumers.

The NOPR proposed more drastic action. It would have created "a rebuttable 'safe harbor' presumption of prudence for certain one-time payments made to extinguish all minimum payment or purchase obligations in certain qualifying contracts." J.A. 529. Qualification would require that the buy-out payment not exceed some percentage of the take-or-pay liability discharge. (The Commission did not specify the percentage in the NOPR. *See* J.A. 536-37.) The responses to this proposal were overwhelmingly negative and reflected a fear that the

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[24] The *Phillips* decision found wellhead sales of gas for resale in interstate commerce to be within the Commission's NGA jurisdiciton. The NGPA removed some instances of existing wellhead sales from the Commission's jurisdiction, and provided, in effect, that its jurisdiction would extend to no future ones except for sales from the outer continental shelf. *See* NGPA § 121, 15 U.S.C. § 3331 (1982).

safe harbor would merely establish a floor for take-or-pay settlements. J.A. 529-40. FERC regarded these complaints as valid and withdrew the safe harbor proposal.

FERC also considered a number of alternate proposals for dealing with the take-or-pay problem. Most prominent of these were proposals that FERC (a) directly invoke its power under § 5 to set aside the take-or-pay clauses of contracts for jurisdictional gas,[25] *see* J.A. 330-33, 1119-21, or (b) condition producer access to Order No. 436 transportation on the granting of take-or-pay relief, J.A. 381-83, 1065-74.[26] FERC rejected

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[25] No party here presents any argument for a view that FERC could exercise its § 5 power directly to modify non-jurisdictional wellhead contracts.

[26] A broad coalition of pipelines and LDCs also advances two less prominent proposals made and rejected during the rulemaking. Brief of Indicated Petitioners and Intervenors on Take-or-Pay Contracts Issue at 31 & n.1. First, petitioners contend that certain take-or-pay provisions in wellhead sales contracts might be deemed in violation of the NGPA. For example, the Commission might find that a contract that provided for sale at the NGPA ceiling *and* allowed a producer to keep take-or-pay prepayments even after it has resold the gas to another party, was in effect a contract for sale at a price in excess of the NGPA ceiling. *Id.* We find this premise somewhat improbable. In enacting the NGPA ceilings, Congress must have been aware that producers and pipelines would incorporate these ceilings into long-term contracts, and that the contracts would include remedies for producers. Obviously the remedial rights would constitute value. If any such value put into breach of the NGPA a contract nominally at the NGPA ceiling, the NGPA would provide a most uncertain guide. Congress may well have supposed that state rules against penalty clauses would suffice to prevent exorbitant remedial provisions. Even assuming *arguendo* that clauses restricting recoupment would violate NGPA ceilings, we do not believe that FERC was obliged to consider the issue in this proceeding in the absence of reason to believe that the economic value of these obligations forms a major portion of the discrepancy between pipeline average contract prices and the wellhead price for newly available gas. *See Motor*

these proposals. Concluding that further regulatory action on problem contracts was neither necessary nor desirable, it made only a trivial adjustment in the April 1985 policy statement.[27]

Virtually all parties other than producers attack FERC's refusal to directly address the producer-pipeline contracts. The essential thesis is this: (1) Order No. 436 denies pipelines much of their leverage over producers—the threat to refuse a producer transportation of new gas when the producer refuses to compromise liabilities under old contracts—at excessive prices. (2) Many pipeline customers will take advantage of open access and CD conversion to escape from dependence on their pipeline suppliers. (3) The escapes will have a spiralling effect—as each additional LDC drops bundled service the gas cost burden will grow, driving still others off. (4) The only LDCs who will remain as pipeline sales customers will be the least nimble—those for whom it is most costly to develop secure supplies from non-pipeline sources. (5) As a result, the consumers who purchase from these LDCs will be stuck with the burden of the overpriced gas, thus defeating the purpose of the Order

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Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 51 (1983).

Second, petitioners suggest that the Commission require pipelines to file tariffs expressing a "cutback policy," pursuant to which the pipeline would not buy gas priced above some specified figure. Brief of Indicated Petitioners and Intervenors on Take-or-Pay Contracts Issue at 31 n.1. If such tariffs were to be legally binding on producers, they would, as the Commission argued, *see* J.A. 332, essentially substitute FERC price controls for the wellhead market, a move clearly forbidden by the NGPA. *See Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709, 716-17 (1986). To the extent that such tariffs would not bind producers, it is hard to see what they would accomplish.

[27] FERC expanded § 2.76(e) to provide that interstate pipelines participating in a take-or-pay settlement shall be deemed to have waived any objection to the producer's application for abandonment.

and violating the consumer-protective purposes of the NGA. *See, e.g., Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 388 (1959); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). Further, FERC's inaction will permanently distort the structure of the natural gas market: by creating an artificial advantage for unbundled transportation service, it will cause the pipelines' merchant role to atrophy, despite the greater efficiency of bundled service. (The greater efficiency derives from pipelines' incurring lower transaction costs in providing a full range of service, including load-balancing service, than would any non-pipeline entity.)

We conclude that FERC's decision to do nothing more than reaffirm the April 1985 policy statement reflects questionable legal premises and fails to meet the requirement of "reasoned decisionmaking." Accordingly, we reverse and remand for further proceedings.

B. *Analysis of FERC's Decision.*

FERC made several contentions in support of its decision against further direct action on the uneconomic contracts. First, it determined that further action was not necessary because Order No. 436 would not cause take-or-pay liabilities to increase, or if it did, the increased liabilities could be shuffled from the pipelines to consumers. Second, FERC invoked a number of policy reasons generally militating against regulatory relief for pipelines. Third, FERC found flaws with the leading alternative proposals advanced by participants in the rulemaking, namely that it use its § 5 power to modify contracts involving jurisdictional gas, and that it condition producer access on the granting of some measure of take-or-pay relief (or allow the pipelines to impose such conditions). We address each of these findings in turn.

1. *Lack of need for additional steps.*

a. *Likely effects of Order No. 436 on take-or-pay build-up.* FERC accepted an industry estimate of about

$7 billion in take-or-pay obligations, J.A. 301-02, though noting the much smaller sum included in pipeline rate bases, J.A. 831, 1069-70. But it made no detailed evaluation of what proportion of these payments—or ones to be made in the future—the pipelines could recoup by later "takes" of gas. It found that pipelines had been able to buy-out substantial portions of their liabilities for about 20¢ on the dollar. J.A. 540. It concluded that these prices were reasonable and that buy-outs were sufficiently widespread to represent a reasonable solution to the problem.

FERC also offered several arguments challengingg petitioners' death-spiral scenario for pipeline sales service.

(a) As to the pipelines' loss of a bargaining chip, FERC observes that the nondiscriminatory access and CD reduction/conversion conditions "are not intended to affect such renegotiations or litigation." J.A. 1070. But FERC's intent is not at issue. What is in dispute is the likely consequence of its acts. On that, FERC offers nothing to undermine the challengers' inherently plausible suggestion that these conditions will have an adverse impact on the pipelines' take-or-pay problems.

FERC also alludes to the "voluntary" character of pipeline provision of Order No. 436 transportation. *E.g.*, J.A. 1072. There are two flaws in this. First, refusal of the option may spell bankruptcy: inability to provide blanket-certificate transportation for fuel-switchable users may in current market circumstances cause critical load loss. Of course acceptance of the option may also be fatal. But when a condemned man is given the choice between the noose and the firing squad, we do not ordinarily say that he has "voluntarily" chosen to be hanged.

Second, the argument obscures distinctions between pipelines in the aggregate and alone. To be sure, Order No. 436 gives pipelines an option, blanket-certificate transportation, which as a result of this court's decision

in *Maryland People's Counsel v. FERC*, 761 F.2d 780 (1985) (*"MPC II"*), is not available outside of Order No. 436. But as soon as a single pipeline finds it attractive enough to accept, each competing pipeline will come under competitive pressure to match the first's flexibility. Thus even if only one pipeline actually preferred to use Order No. 436 (hanging rather than being shot), competition might force others—ultimately perhaps all the others—to switch their preference. Thus the Order effectively reduces pipeline ability to face down recalcitrant producers.

(b) FERC argues that the CD conversion/reduction provisions may not injure the pipelines at all.

> [T]he Commission considers it more likely that [the LDCs] will either convert to firm transportation on the same pipeline, or else free up underutilized capacity under uneconomic CDs for use by other customers on the same pipeline. In either case, the pipeline may actually increase throughput and, therefore, gain the net benefits of spreading its fixed costs over greater units of gas service.

J.A. 1068-69.

But customers' conversion to transportation will clearly aggravate a pipeline's ability to resolve the problem of its overpriced gas inventory. Nor can the Order's CD reduction provision be painless: a pipeline would voluntarily agree to release an LDC whenever it had equally profitable business opportunities for the pipeline capacity thus made available; accordingly, the only cases where Order No. 436 *causes* CD reduction will be ones where the reduction does injure the pipeline. FERC's analysis provides no reason to suppose that those instances will be negligible.

(c) FERC contends that under competitive pressures a pipeline "will seek to adjust its gas purchasing practices so as to lower its weighted average cost of gas

to all customers." J.A. 1069 (emphasis in original). This reasoning assumes away the problem of the uneconomical contracts to which pipelines are presently bound. All FERC does here is to admit that Order No. 436 dramatically increases the consequences of not getting out from under an uneconomical contract. It seems to confuse the pipelines' *incentives* to renegotiate contracts with their *ability* to do so.

(d) FERC suggests that "[a] pipeline may determine that certain of its existing business arrangements make participation in the new rules unwise or undesirable," and suggests possible alteration of the pipeline's "leveraged capital structure" and "the extent of its non-pipeline business interests." J.A. 1067. To the extent that this implicitly recommends some sort of spin-off of assets or borrowing increase, preparatory to bankruptcy, it seems unrealistic in light of market conditions, the rules against transfers in fraud of creditors, and "pierce-the-corporate-veil" principles.

(e) FERC finds two affirmative advantages for pipelines in Order No. 436. First, the Order affords producers a procedure for expedited "abandonment" (*i.e.*, extinction of the legal commitment of the gas to the seller named in the producer's certificate under the NGA) where a take-or-pay settlement has been reached or where a producer experiences substantially reduced takes without payment. 18 C.F.R. §§ 2.76(e), 2.77. In the latter case, it argues, abandonment will enable the pipeline to invoke contract defenses against a producer that resells the gas, specifically mitigation of damages. J.A. 1071-72. It is unclear how useful this may be, for the pipelines' whole problem is the excess of the contract price over the current market price. That differential is the source of pipeline vulnerability, and expedited abandonment does little or nothing to cure it.[28]

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[28] We reject the American Gas Association's attacks on the expedited abandonment provisions. These provisions merely out-

Second, the Commission suggests that Order No. 436 might aid the resolution of take-or-pay problems by not precluding

> any gas shipper, whether end-user, LDC, or independent broker, from negotiating *on its own behalf* a condition in a "self-help" gas sales contract which would require the producer-seller to grant take-or-pay relief to the shipper's pipeline supplier before the shipper takes delivery of the gas.

J.A. 1073-74 (emphasis in original). Assuming FERC will stand by the underscored phrase, the scenario seems most unlikely. No reason appears why any of those persons would, in its bargaining with a supplier, sacrifice anything of value in order to secure a benefit for the pipeline. (Nor would the supplier agree to it without securing something in exchange.)

In sum, FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability, and its tendency to elevate into affirmative benefits what are at best palliatives, seem impossible to square with the requirement of reasoned decisionmaking.

b. *Pipeline ability to shift costs downstream.* The Commission suggests that pipeline complaints about Order No. 436 are undercut by its having reserved the ability to shift costs downstream to customers.

> To the extent a pipeline in fact incurs additional take-or-pay liability due to transportation services under Order No. 436, nothing in Order No. 436 is intended to preclude the Commission from determining the appropriate allocation of revenue responsibility among the pipeline and its customers in an in-

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line circumstances in which FERC will proceed in an expedited manner. They do not change FERC's policy as to when abandonment is in the public interest, and we have already upheld FERC's power to streamline its procedures in this manner. *See supra* part IV.A.2.

dividual rate case filed to reflect the adjustments in sales and transportation service.

J.A. 1070-71.

While it is unclear what weight the Commission attaches to this possibility, it seems important to call to mind two legal limits on the Commission. On one hand, simply moving costs downstream to customers must at some point conflict with the Commission's duty to "adequately attend[] to the agency's prime constituency—the consumers whom the [NGA] was designed 'to protect . . . against exploitation at the hands of natural gas companies.'" *MPC II*, 761 F.2d at 781 (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944)). On the other hand, the Commission's power to directly restrict pipelines from passing costs through is limited: it can limit passthrough of gas purchase costs made in compliance with the NGPA only if the payments arose out of "fraud or abuse," NGPA § 601(c)(2), 15 U.S.C. § 3431(c)(2) (1982), and it can limit passthrough of other costs (including, under the Commission's view, take-or-pay settlement costs), only to the extent not "prudently" incurred, *see* 18 C.F.R. § 2.76(d).

Despite these constraints on the Commission's power to limit passthrough *by decree*, it has considerable ability to protect consumers by bringing about *market conditions* that prevent a pipeline from passing costs forward. The NGPA's legal limits on restricting passthrough clearly do not bar rules tending to generate such market conditions. *Cf. supra* part IV.B. Indeed, that is the principle underlying Order No. 436. At least two other factors, however, restrict the Commission's room for maneuver here. (1) To the extent that the Commission allows gas costs in a pipeline's rate base for transportation purposes, a possibility that it seems to leave open, J.A. 423, the costs will flow through the customers despite open access. (2) To the extent that it allocates large take-or-pay liabilities exclusively to gas costs, it seems likely to

eradicate the pipelines as merchants, for under such a rule all customers would convert their entire contract demand, except for a limited class of customers: those who find it unusually costly to arrange their own non-pipeline sources of supply or who are pressured by state regulatory commissions to adhere to reliance on pipeline supplies.

In sum, the Commission seems to exaggerate pass-through to customers as a solution to the problem of uneconomic contracts. If Order No. 436 works as intended, economic constraints will make passthrough impossible, except for customers—likely not accounting for a large proportion of the interstates' total gas sales—that are exceptionally sclerotic about purchasing gas from brokers or producers.

2. *Policy considerations militating against any intervention.*

In refusing to modify producer/pipeline contracts, FERC noted that such action would "raise extremely serious questions regarding the ability of private parties in the gas production industry to rely on private contracts as a tool for structuring basic economic relationships." J.A. 332. In its brief, moreover, FERC invokes the need to be sensitive to the congressional policy decision, inherent in the NGPA, "to move toward a deregulated gas commodity market." FERC Brief at 130-31. As the Supreme Court has recently stated, "To the extent that Congress denied FERC the power to regulate affirmatively particular aspects of the first sale of gas, it did so because it wanted to leave determination of supply and first-sale price to the market." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709, 717 (1986).

The Commission also invoked the closely related policy of holding pipelines accountable for their decisions in order to induce them to act more in the manner of firms in a competitive industry. J.A. 44-48. Although the context was a discussion of risk allocation as between pipe-

lines and their customers, FERC's reliance on it in that context underscores FERC's commitment to the policy of nurturing a competitive wellhead market.

In essence FERC argues that the pipelines' subjection to regulation is hardly, in itself, a reason why they should be able to escape contractual liability more readily than unregulated firms. Like those firms, pipelines are able to invoke the doctrines of impossibility and impracticability and to assert defenses under *force majeure* clauses.[29] They may also be able to persuade their suppliers to accept contract adjustments by appealing to the latters' long-term business interests. These steps would be the only recourse open to an ordinary middleman in a competitive market who had entered into unlucky or improvident contracts. FERC suggests that pipelines should not enjoy an extra means of escape.

FERC invokes the same principle in distinguishing producer-pipeline contracts from those between pipelines and LDCs, which it proposes forcibly to adjust pursuant to the CD conversion and reduction options. First, FERC notes that, unlike a provision granting pipelines relief from uneconomical supply contracts, the CD conversion/reduction option is essential if Order No. 436 is to carry out its fundamental purpose of providing all parties meaningful access to low-cost gas. *See* J.A. 414-25, 1119-21. *See also Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) (*"MPC I"*); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*"MPC II"*); *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (*"MPC III"*). Second, FERC highlights the fact that the troublesome pipeline-producer contracts are largely "straightforward commercial agreements" while pipeline-consumer con-

[29] FERC has asserted that nothing in Order No. 436 "is intended to abridge the rights and obligations regarding take-or-pay liabilities under contracts between those pipelines and their suppliers, including any right to raise *force majeure* as a defense in an appropriate case." J.A. 1231.

tracts are heavily regulated "utility-type 'service agreements.'" J.A. 1120.

FERC's policy arguments in favor of subjecting pipelines to the pressures of a competitive market seem powerful and well grounded in the statutes it is authorized to enforce. Lest the Commission on remand place undue weight upon them, however, we must note some limits. Most important, producers' access to transportation under Order No. 436 is itself dependent on government intervention. To condition that access on some producer cooperation in disposing of outstanding contracts is hardly identical to raw governmental abrogation of the contracts. Second, while the middleman buying and selling in competitive markets will bear the risk associated with his bad luck or improvidence, the pipeline's market power allows it to pass some of that burden forward. As noted above, some portion of that ability will remain despite "open access" under Order No. 436 and despite FERC's view that passthrough of buy-out costs is permissible only where they have been prudently incurred. Third, the pipelines have been caught in an unusual transition. They entered into the now uneconomic contracts in an era when government officials berated pipeline management for failures of supply and constantly predicted continuing energy price escalations. Moreover, as sales and transportation were then wholly bundled, and unregulated pipeline gas trading affiliates were unknown, there was no way that a pipeline could generate direct profits on the gas-trading component of its business. Thus, their being abruptly and retroactively subjected to the downside risk is at least jarring. *See* Carpenter, Jacoby & Wright, *Adapting to Change in Natural Gas Markets*, in *Energy, Markets & Regulation: Essays in Honor of M.A. Adelman* 1 (1986) (tracing evolution of natural gas pipelines' exposure to risk). For the reasons already noted, *see supra* part IV.B., the resulting equities are not enough to block necessary pro-competitive reforms. But they are not weightless.

3. *Reasons for rejection of specific proposals.*

a. *Section 5 action against jurisdictional contracts.* In rejecting the proposal that it invoke its § 5 power directly to set aside jurisdictional contracts with troublesome take-or-pay provisions,[30] the Commission reasoned that because such a remedy would be incomplete, its use would be both inequitable and inefficacious. As a result of the NGPA, the proportion of wellhead sales that are jurisdictional is steadily declining. "It would be inequitable," the Commission said, "to allow pipelines to reduce their takes only under contracts still subject to the Commission's NGA jurisdiction, particularly because many of the problem contracts are not subject to the Commission's jurisdiction." J.A. 1121. If in fact jurisdictional contracts account for only a small proportion of the troubling price discrepancy, we can well understand the Commission's viewing the invocation of § 5 as unpromising—at least unpromising enough to justify its proceeding with open access and deferring the abrogation approach. Elsewhere, however, the Commission states that "the bulk of high-cost 'problem' contracts without 'market-outs' may be those entered into prior to 1982 involving offshore gas regulated under NGPA section 102 [*i.e.*, jurisdictional]." J.A. 1072. *See* NGA § 601(a)(1)(B), 15 U.S.C. § 3431(a)(1)(B) (1982) (preserving NGA jurisdiction over gas from Outer Continental Shelf). On remand FERC must make clear the extent to which contracts for jurisdictional gas account for the basic economic problem.

In addition to the ambiguity in the factual underpinning of FERC's argument, we have some difficulty with the claim of inequity. In the NGPA Congress selected a particular device for bringing about a transi-

[30] The Commission has no power under § 5 to set aside or modify clauses in producer contracts relating to non-jurisdictional gas. *See Pennzoil Co. v. FERC*, 645 F.2d 360, 380-83 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

tion from the *Phillips* world, with all wellhead interstate sales for resale subject to Commission jurisdiction, to a quite different world, with only Outer Continental Shelf wellhead sales jurisdictional. The device was primarily one of perfectly standard grandfathering. Whatever inequity may flow from some producers suffering the consequence of failing on the wrong side of the line, while others fall on the right side, appears to be no more than the usual result of grandfathering.

The above discussion may not accurately capture the Commission's concern. It has, rightly, we think (*see supra* pp. 87-89), placed great weight on the congressional determination that market forces should operate freely at the wellhead. Even for jurisdictional contracts, moreover, Congress has provided that prices at or below the NGPA ceilings are "just and reasonable." NGPA § 601(b), 15 U.S.C. § 3431(b) (1982). Thus FERC is clearly barred from setting sub-NGPA ceilings on jurisdictional wellhead sales. Assuming that the Commission may find specific take-or-pay percentages to violate § 5, *see Columbia Gas Transmission Corp.*, Opinion No. 204, 26 F.E.R.C. ¶ 61,034, at 61,120 (1984), *aff'd in part and reversed in part sub nom. Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 229 (D.C. Cir. 1986), it may well fear that action against take-or-pay provisions without regard to price would be both ineffective and inequitable: ineffective because it would not reach many contracts that are deleterious only because very high price provisions combine with otherwise harmless take-or-pay clauses; inequitable because it would restrict contracts that are harmless despite high take-or-pay provisions.

The Commission has not expressed the meaning of its reasons for inaction on jurisdictional contracts clearly enough for us to determine the legality of its analysis.

Accordingly, it should on remand reassess its refusal to act under § 5.[31]

b. *Conditioning producer access.* In refusing to condition producer access on cooperation in solving take-or-pay issues (or to allow pipelines to impose such a condition), FERC asserts that it would be unduly discriminatory for a pipeline to refuse transportation service under Order No. 436 "merely because the producer and pipeline cannot agree on take-or-pay relief in another contract." J.A. 1073. It believes that such a refusal would discriminate not only against the producer-seller but also against the would-be buyer to whom the pipeline would have carried the gas but for the proposed condition. *Id.*

Insofar as the argument simply states that such a refusal would violate the anti-discrimination concept manifested in Order No. 436 itself, it obviously provides no justification for FERC's having chosen to so delineate its anti-discrimination concept. Insofar as it interprets § 5's prohibition of "undue discrimination," the analysis seems very unpersuasive. Given that the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure, J.A. 315, it eludes us why pipeline denial of access to producers that stand on the letter of their contract rights should be viewed as unduly discriminatory. It is clear that § 5 does not prohibit every distinction. *See Saint Michaels Utilities Comm'n v. FPC*, 377 F.2d 912 (4th Cir. 1967); *cf. Texas & Pac. Ry. v. ICC*, 162 U.S. 197, 218-19 (1896) (one of long line of cases finding Interstate Commerce Act's prohibition of dis-

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[31] We note that the effectiveness of a solution may be a relative matter. If the Commission on remand should adopt some access condition that realistically promises to solve the problem of troublesome producer-pipeline contracts, that would alter the context of its determination whether specific take-or-pay clauses in jurisdictional contracts are unjust or unreasonable.

crimination not to bar every rate differential). FERC offers no reason why it views this one as beyond the pale.

The Commission's response may arise out of a concern that any such condition would give pipelines a veto power over transportation of each producer's gas. We think such a fear underestimates the Commission's power to impose both procedural and substantive limits on pipeline use of any conditioning power. First, it could obviously require that the pipeline specify the allegedly offending contracts, thus preventing pipelines from transforming the condition into one allowing them unlimited discretion. Second, without even addressing the nuances of which price and percentage terms are truly objectionable, it could limit the condition rule to disputes over contracts entered into before some date; it could select the date, for example, as of which it had become reasonably clear that the NGPA's premise—the notion that the market price of gas would never fall below NGPA ceilings—had ceased to be valid. Third, it could explore the possibility of developing rules that would identify the price and take-or-pay provisions that unduly thwart the Commission's purpose in Order No. 436 and its duty under the NGA to protect consumers.

We do not mean to suggest that the Commission need consider any of the options discussed. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Ins. Co.*, 463 U.S. 29, 50-51 (1983). Our point is simply that the Commission seems not to have made much of a case against a condition of the sort proposed. Given the serious threat to Order No. 436's fulfillment of the Commission's statutory goals, we think that rejection of such a proposal requires more explanation than the Commission has offered.

Finally, the suggestion that any access-conditioning rule would unduly discriminate against customers seems to us at best ill-developed. Generally speaking, one might expect customers and consumers to be unanimous in fa-

voring any exercise of FERC power that would help to eradicate the supra-market contracts. Many customers and customer representatives join the brief demanding greater action on take-or-pay; no gas purchaser opposes it. Of course a purchaser that arranged for a bargain purchase of gas would be disappointed to see the deal founder on the producer's take-or-pay recalcitrance. But, recognizing the reasons underlying the barrier, it would be likely to accept the occasional burden as a just one.

Some producers support FERC's rejection of access-conditioning by invoking the concept that with such a condition the Commission would be doing indirectly what it is forbidden to do directly—*i.e.*, regulate wellhead prices. The Commission itself at one time appeared to make an essentially similar argument, when it said "there is a serious question as to whether the Commission has the authority to require a nonjurisdictional party to give up a valid contractual right as a condition to obtaining service." J.A. 381. *See also* J.A. 331 ("It is the Commission's tentative judgment that Congress, through its decisions to ultimately decontrol all natural gas supplies (as old gas is depleted), determined that the workably competitive wellhead market would do a better job of setting such rates for the commodity than would a utility regulatory body."). But by the rehearing stage FERC had ceased to invoke the position (at least in this form), *see* J.A. 1065-74, and by the time of briefing seemed to repudiate it, FERC Brief at 129. However, since some petitioners invoke the argument, we address it briefly.

That access-conditioning and wellhead price controls might have somewhat similar effects (lower wellhead prices) does not make them the same thing at all. Order No. 436 mandates access in order to solve unprecedented problems in the natural gas market. That access will give producers entirely new market opportunities. Order No. 436 would create these opportunities not because the

statute expressly mandates that producers should enjoy them, but because the Commission believes that such access is a well-designed corrective for practices that it finds unduly discriminatory. If it is appropriate for the Commission to bar refractory producers from the benefits of Order No. 436 in order to fulfill the underlying statutory mandate, then the fact that this constitutes a form of government pressure to reduce prices is itself no barrier.

C. *Conclusion.*

In deciding on inaction, FERC (1) assessed the hazards created by Order No. 436, finding them likely to be nil, (2) invoked certain policy concerns militating against action, and (3) rejected as flawed a variety of alternative proposals suggested during the rulemaking proceedings. Recognizing that the Commission is expert in this area, we nevertheless find its stated legal premises questionable and its factual assessments utterly Panglossian. In contrast, its primary policy concerns seems to us forceful ones. We remand to the Commission to determine, in light of our discussion of its questionable factual and legal premises, to what extent these policy considerations may justify its inaction on the uneconomical producer-pipeline contracts. We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking.

VI. Optional Expedited Certification

Order No. 436 sets out to ameliorate certain anti-consumer and anti-competitive consequences of the Commission's classical approach to certification under the NGA. Before a pipeline may acquire or construct any facilities or offer any transportation or sales service subject to the Commission's NGA jurisdiction, it must obtain a § 7 certificate authorizing the acts. The Commis-

sion must issue such a certificate where it finds that the applicant is able and willing to do the acts and perform the service proposed, and the facility or service is or will be required by the present or future public convenience and necessity. NGA § 7(e), 15 U.S.C. § 717f(e) (1982). Historically, the Commission's approach to certification has entailed an elaborate effort to predict the likely consequences of allowing the proposed service or act. This included the Commission's foretelling—or, more realistically, attempting to foretell—the impact of certification on, for example, shareholders and customers of both the applicant firm and those of any firm whose sales would be displaced. *See, e.g., Atlantic Seaboard Corp. v. FPC*, 397 F.2d 753, 756 (4th Cir. 1968); *Tennessee Gas Pipeline Co.*, 22 F.E.R.C. ¶ 61,174, at 61,294-96 (1983); *Natural Gas Pipeline Co.*, 20 F.E.R.C. ¶ 61,324, at 61,675 (1982), *reh'g denied*, 21 F.E.R.C. ¶ 61,223 (1982), *amended* 21 F.E.R.C. ¶ 61,231 (1982); *Columbia Gulf Transmission Co.*, 37 F.P.C. 118, 131, *reh'g denied*, 37 F.P.C. 591 (1967), *aff'd sub nom., Atlantic Seaboard Corp. v. FPC*, 397 F.2d 753, 757-59 (4th Cir. 1968). The process has been time consuming, *see, e.g., Natural Gas Pipeline Co.*, 30 F.E.R.C. ¶ 61,017 (1984) (Commission approval on January 14, 1985 of application filed June 1, 1982), and costly; it also utterly stifles the sort of quick responsiveness to demand that is associated with competition.

Order No. 436 seeks to stimulate competition and to enhance consumers' access to the wellhead market by making an optional expedited certificate ("OEC") procedure available to pipelines seeking to provide "new service" (*i.e.*, transportation or sales service of a different magnitude or kind than it currently provides, 18 C.F.R. § 157.101(b)(2)) or to acquire or construct facilities to do the same. To qualify for the OEC procedure, a pipeline must meet criteria designed by the Commission to assure that it assumes the full economic risk of the ven-

ture.[32] Applicants who agree to these conditions receive in return the benefit of a rebuttable presumption that the facility or service meets the statutory prerequisites of certification, 18 C.F.R. § 157.104(c), and thus enjoy the possibility of escaping the usual cumbersome hearing, 18 C.F.R. § 157.104(b). Protesters who wish to challenge the certification in a full hearing must raise genuine issues of material fact as to compliance with the statutory criteria.

This facet of the Commission's order has provoked the greatest concern among state commissions and LDCs. These parties fear that pipelines will be able to take advantage of the OEC procedures to obtain all of the facilities and certificates necessary to deliver gas directly to end users, bypassing the LDCs currently making such sales. Such bypass, if it occurs, would at least in the short run reduce the bypassed LDC's volume and thus force either its shareholders or remaining customers to shoulder higher costs (the so-called "cost-shifting" prob-

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[32] *See* J.A. 553. The regulations adopted in Order No. 436 provide that projections of units of service may never be decreased, § 157.103(d)(4), *i.e.*, the pipeline cannot secure a rate increase by demonstrating that service has fallen below expectations; that costs originally allocated to the new service may be shifted only on a showing that they are being incurred for the benefit of other services, § 157.103(d)(8); and that the pipeline may not, for sales service (firm or interruptible), impose any charge tending to guarantee revenue, such as a demand charge or a reservation fee, § 157.103(e).

If the applicant seeks a certificate to provide transportation for others under the OEC procedure it must also apply for a blanket certificate under § 284.221, thereby exposing its entire transportation network to the conditions of Order No. 436, such as nondiscriminatory access and CD adjustment. Once a pipeline has obtained a blanket transportation certificate, it would no longer need case-specific certification. As a practical matter this appears to render the OEC route useful only in obtaining a certificate to provide sales service, or, more importantly, to construct or acquire new facilities.

lem). Accordingly, the state commissions and LDCs attack both the substance of the OEC rule and the procedures established for its application.

A. *Ripeness.*

So far as we know, no pipeilne has yet applied for expedited certification, so that none of the rule's substantive or procedural terms has yet been applied in a concrete setting. Indeed, we may not freely assume that *any* pipeline will ever invoke the option: the rule's criteria may chill all possible applications. Accordingly, we face a preliminary question of whether the challenges to this part of Order No. 436 are ripe.

The functions of the ripeness doctrine are well-established:

> [The doctrine's] basic rationale is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.

Abbott Laboratories v. Gardner, 387 U.S. 136, 148-49 (1967). The Court in *Abbott Laboratories* went on to derive from these criteria its well-known test, requiring us to evaluate "both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration." *Id.* at 149.

Petitioners' claims may for ripeness purposes be divided into two classes, loosely speaking the attacks on the rule's substance and those on its procedures. We find the first ripe, the second not. Concerning the substance of the rule, petitioners claim that the Commission in adopting it disregarded values that Congress required it to consider (*e.g.*, impact upon LDCs' residential customers, the need to prevent wasteful investment), make

unsupported assumptions (*e.g.*, that under the rule pipelines would really bear the full economic risk and that LDCs were really in a position to compete with pipelines on an equal footing), and failed to supply adequate reasons (especially for its abolition of a prior policy against bypass). These issues seem fit for judicial review, and we believe that delay in resolving them will impose material hardship on the challenging parties.

In the OEC provisions of Order No. 436, the Commission clearly states that it will consider itself free to certify proposed facilities or service whenever (1) it receives a qualifying application and (2) no opposition is filed. The implication, indeed, is that this will ordinarily be the outcome. Special circumstances seem needed to defeat the application; one relevant factor, for example, is whether the applicant has committed itself to nondiscriminatory transportation under Order No. 436. *See* J.A. 568, 1362. Moreover, the Commission expressly states that in an OEC proceeding it will not allow onto the agenda certain issues formerly cognizable in § 7 hearings: duplication of facilities, the problem of cost-shifting in a bypassed distributor's rates, or impact on local interests generally. FERC Supp. Brief at 6, 8.

This is a reasonably specific, concrete proposition. Action under the OEC regulations appears likely to be virtually as automatic as under the policy statement at issue in *Nader v. CAB*, 657 F.2d 453 (D.C. Cir. 1981), in which the CAB stated that it would not suspend any fare filing that fitted within a band surrounding the fare that a specific formula would produce. We found the policy statement ripe for review (without even considering the "hardship" component of ripeness), noting that the "mandatory language . . . narrowly circumscribes the Board's discretion to suspend air fares" within the prescribed bounds. *Id.* at 456. Though the Commission does not here commit itself to an automatic outcome (*i.e.*, it does not employ mandatory language), it signifi-

cantly circumscribes its discretion. It commits itself to grant applications that meet specific criteria, at least so long as offsetting factors do not appear. And while the Commission has not furnished an all-inclusive list of possible offsetting factors (the list is in a sense open-ended), it has expressly removed from the list many factors that have historically dominated § 7 proceedings. Thus one can state a range of hypotheticals and predict the Commission's disposition with a fair degree of confidence. That some issues are unresolved does not in itself render unfit the ones that the agency has clearly determined. *See Continental Air Lines v. CAB*, 522 F.2d 107, 125-26 (D.C. Cir. 1975).

In some respects, fitness is clearer here than in *Nader*. Not only has the Commission made clear it considers the regulations final and outcomes largely predetermined, *see Continental Air Lines*, 522 F.2d at 125, but the action takes the form of specific regulations adopted after a notice-and-comment rulemaking rather than a mere policy statement.

Moreover, the Commission's decision is reasonably likely to have an effect on the primary conduct and day-to-day affairs of at least some of the petitioners. *Cf. Toilet Goods Ass'n v. Gardner*, 387 U.S. 158, 164 (1967). The creation of the presumption, and the refusal to except instances of LDC bypass, increase the risk that such bypass will occur. That incremental risk clearly gives LDCs an incentive to make immediate adjustments in their business—for example, to attempt to renegotiate their contracts with end users, to lean up their operation in an effort to be more competitive, or to bring their rate structures more closely into alignment with costs. Indeed, in adopting the rule the Commission expressly noted its tendency to create economic incentives to promote economic efficiency. *See* J.A. 561; *see also* FERC Brief at 165. This likely impact on petitioners' primary conduct, coupled with the fitness of the issue for judicial review,

render the Commission's adoption of the presumption ripe for review.

The same cannot be said of petitioners' attacks on procedural aspects of the OEC presumption. These attacks revolve around the thesis that the Commission's procedures may hamper their ability to mount effective attacks on proposed new services. Petitioners argue, for example, (1) that the Commission's creation of a presumption illegally switches the burden of proof from the applicant to protesters (Brief of the State Commission Petitioners on Bypass Issues at 18-22; Brief of United Distribution Companies at 28-29); (2) that the provisions for change of delivery points might in practice allow pipelines to deliver at a previously unauthorized location (thereby entailing bypass possibilities not suggested by the initial OEC application) (Brief of the State Commission Petitioners on Bypass Issues at 34-37); (3) that the Commission procedures would not allow protesters to ascertain facts essential to formulating their objections (Brief of the State Commission Petitioners on Bypass Issues at 37-41; Brief of the American Gas Ass'n at 23-24; Brief of Associated Gas Distributors at 36-37); and (4) that the Commission's provisions for a "noncontested proceeding" might be triggered even in cases where a genuine contest existed[33] (Brief of Associated Gas Distributors at 17-19).

All these attacks share a highly abstract and speculative character. On the first two issues the Commission asserts that petitioners have misread the regulations and are thus attacking phantoms of their own imaginations, *see* FERC Brief at 172-79; its view is certainly not implausible. All the claims seem likely to turn on individualized, fact-specific situations that are not before us. Some conceivable application—or misapplication—of the Commission's "noncontested proceeding" regulations might

[33] Compare § 157.104(b) with § 385.802.

unduly truncate a protester's rights, but that possibility hardly justifies our issuing an advisory opinion on a vast range of possible situations. The claim about possible informaiton gaps suffers the same flaw.

The character of these attacks seems even more abstract and speculative than that of the ones found unfit for review in *Abbott Laboratories*'s companion case, *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967). There the Court considered regulations allowing the Commissioner of Foods and Drugs to suspend certification service (a necessity for marketing the regulated commodities) whenever a subject of the regulation refused FDA inspectors "free access" to their manufacturing facilities. The Court reasoned that until the regulations were applied it could not know whether or when the Commissioner might order an inspection, or what reasons he might give for doing so. *Id.* at 163. Resolution of the legal issues would turn on the FDA's enforcement problems, the need for supervision, and safeguards for protection of trade secrets. The Court believed that all could be resolved better in the setting of a specific application rather than "the framework of the generalized challenge made here." *Id.* at 164. *See also Association of National Advertisers v. FTC*, 617 F.2d 611, 620 (D.C. Cir. 1979) (finding a challenge to certain Federal Trade Commission procedures unfit for review as it would entangle the court "in an essentially abstract discussion of the [challenged procedures'] potential effects").

Nor do petitioners demonstrate that they would suffer the slightest hardship as a result of our declining immediate adjudication of their claims. Again *Toilet Goods* controls. There the Court argued that the "free access" regulation was most unlikely to affect "primary conduct" —the challengers' behavior in the day-to-day world of negotiating contracts, testing ingredients or compiling records. 387 U.S. at 164. It has been argued that in fact the Court overlooked a likely impact on primary con-

duct, namely, that drug manufacturers might reallocate resources away from development of drugs dependent on secret formulae. *See* Vining, *Direct Judicial Review and the Doctrine of Ripeness in Administrative Law*, 69 Mich. L. Rev. 1445, 1502-04 (1971). Here we see no hazard at all that uncertainty about these procedural flaws could materially alter any of the challengers' decisions about how to conduct their business operations. The connection is far too iffy.

Accordingly, for want of both fitness for review and any material hardship to the challengers, we dismiss the procedural claims as unripe. We now turn to the merits of the petitioners' challenge to the Commission's creation of the presumption.

B. *Legality of the Presumption.*

The OEC aspect of Order No. 436 enables pipelines to make an occasional end-run around the costs and delays of ordinary certification. It establishes criteria aimed at assuring that the applicant will bear the full economic risk of the venture. The Order takes the position that, if the applicant agrees to those criteria, and no offsetting factors appear, the various public interest concerns explicit or implicit in § 7 will be satisfied.

1. *Alleged disregard of legally relevant factors.*

Petitioners' primary claims revolve around the idea that the Commission's innovation disregards important factors that Congress intended the Commission to consider. Most prominent among these allegedly neglected factors are (1) the risk of waste through construction of duplicative facilities and (2) adverse impact on the customers of bypassed LDCs.[34]

[34] Petitioners appear to make no claim that the Commission was not procedurally free to use a rulemaking to identify in advance the criteria on which it would grant or deny certification. It is, of course, far too late in the history of administrative law for any such

It seems clear that among the congressional purposes in providing for certification was "to prevent uneconomic extensions and waste."[35] But it is equally clear that Congress has adopted no general policy against firms taking *their* (*i.e.*, their investors') money and applying it to projects that may prove unjustifiable in terms of the ultimate return. What generates special concern about wasted investment in the context of a regulated monopoly is that the ultimate bearers of the risk may be the consumers rather than the investors. For example, investment in a particular stretch of pipeline typically goes into the regulated firm's rate base, its cost to be recovered out of rates charged all the firm's customers. Since regulation supposedly holds the rates below profit-maximizing levels, the firm has no difficulty collecting the charge if the regulators authorize it. And it can do this even though the new investment proves a complete loser.

This risk-shifting under regulated monopoly contrasts sharply with conditions in either a competitive or an unregulated industry. Where competition prevails, a firm cannot compensate itself for losses on one venture by raising prices on other lines of business; if it tried to do so, competitors could profitably capture the business. And an unregulated firm, even if monopolistic, will have sought the profit-maximizing price and output for each of its goods or services; thus a price increase on some lines, aimed at recouping losses on another, would only aggregate its loss.

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claim to succeed. In both *FPC v. Texaco Inc.*, 377 U.S. 33 (1964), and *United States v. Storer Broadcasting Co.*, 351 U.S. 192 (1956), the Court upheld the use of rulemaking to identify necessary (but not sufficient) criteria for licensure. Here the Commission has identified criteria that are conditionally sufficient for certification. We see no difference in principle, and indeed we upheld such a provision in *National Tour Brokers Ass'n v. ICC*, 671 F.2d 528 (D.C. Cir. 1982).

[35] *See* S. Rep. No. 948, 77th Cong., 2d Sess. 7 (1942); *see FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 13 n.9 (1961).

The challenge before the Commission was to see whether it could accomplish the congressional intent of protecting ratepayers from such risk-shifting and at the same time allow natural gas customers to benefit from investment and competition freed from the deadening effects of the system of certification that had evolved over the years since 1938. Its OEC procedures are thus an experiment designed to realize the congressional scheme, not to defeat it.

The losses possibly to be suffered by existing firms, whose business the applicant may capture, are another matter. But the Commission's criteria also address that problem. Firms will apply only when their managements believe that they will be able to capture enough business to repay the investment. That estimate will be correct only under certain circumstances: there must either be undercapacity in the market (so that the applicant and incumbent firms can both enjoy an adequate return), or the incumbent firms must be performing so inefficiently that the applicant can underprice them, or the incumbent firm must be discriminating in price against the customer or class of customers that the new entrant seeks to serve. If undercapacity is the explanation, the investment entails no waste. If incumbent-firm inefficiency or price discrimination is the explanaton, then certification will result in losses for a firm that, so far as appears, deserves to lose. (We address below the special case of an incumbent firm that loses business because the state regulatory agency has *forced* it to engage in price discrimination.)

Thus certification under the OEC rules seems likely to occur only when the risk of wasteful investment is remote. Of course the applicant pipeline may err; all of us do. But the Commission has at least implicitly estimated that the risk of error by a pipeline management, with its company's solvency at stake, is no greater than the risk of error by the Commission itself. *See* J.A.

593-95. The Commission also anticipated that by lowering bureaucratic barriers to entry the rule would afford consumers the benefits of competitive (or at least more competitive) pricing. *See* J.A. 553, 561. As the Commission has given the applicant firms an incentive to make the decision correctly, we cannot gainsay its belief that the rule will in fact protect consumers from the adverse consequences of inefficient construction.

But where entry will inflict deserved losses on an incumbent LDC, some or all of those losses may ultimately fall not on its shareholders but on its remaining customers—most notably its captive residential consumers. Several petitioners strenuously argue that the Commission's presumption violates congressional purpose to the extent that it creates such a risk. *See* Brief of the American Gas Ass'n at 15-19; Brief of Associated Gas Distributors at 15-16; Brief of the State Commission Petitioners on Bypass Issues at 24ff.

The Commission argues that the risk is slight, that state regulatory agencies have the necessary authority to keep it slight or reduce it even further, and that those agencies can protect captive consumers in the instances where it does occur. We find the Commission responses persuasive.

First, FERC notes that the record contains little to suggest that industrial consumers want to bypass their distributors. *See* FERC Brief at 158 n.1. Indeed, it seems logical to suppose that what they want is gas at competitive prices. So long as the LDC will provide such gas—either as merchant or as transporter of gas bought at the wellhead or from a broker—the customer will have no incentive to try to induce pipeline investment in new facilities for a bypass. So long as the LDC is able to gain a return from the provision of transportation services, reduced purchases by the industrial buyer will normally have no more than a modest negative impact.

Second, state agencies have a variety of powers by which to control the risk of bypass. That risk seems to derive primarily—perhaps almost exclusively—from LDCs using industrial rates to subsidize residential consumers, perhaps under regulatory pressure from state commissions. The Commission so asserts, FERC Brief at 159 n.1, and the record provides at least implicit support. Several commentators asserted that pipelines would "skim the cream" from among a distributor's customers, J.A. 559. *See also* Brief of Associated Gas Distributors at 32 (alluding to the potentially contested industrial user as a "lucrative customer"). "Cream-skimming" necessarily involve cross-subsidization: a customer is "creamy" simply because the rate structure allows the firm to extract from it a disproportionate share of costs. *See, e.g.*, E. Gellhorn & R. Pierce Jr., *Regulated Industries* 275 (2d ed. 1987). Consequently, the Commission suggests, state agencies can head bypass off by adopting more strictly cost-based rate designs. *See* J.A. 1260.

State agencies may also control bypass by virtue of their jurisdiction over the bypassing transportation itself. The Supreme Court has upheld state power to require a pipeline to obtain from it a certificate of convenience and necessity before selling gas at retail (and bypassing an LDC), even where it recognized that the "end result" of the requirement might be "prohibition of particular direct sales." *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329, 336 (1951). The exact scope of this power is unplumbed, and is not before us now. But *Panhandle* clearly tends to undermine petitioners' assault on the Commission's refusal to except bypass situations from the OEC procedures, insofar as that assault turns on assumptions of total state incapacity to address the issue.

Similarly, the suggestion of our partially dissenting colleague that the OEC rule has "overridden the states' ability" to subsidize residential consumers by charging

higher rates to large industrial customers, *see post* at 3, is correct only in a very limited sense. For example, even if we disregard the residual authority left in place by *Panhandle*, a state is free to tax gas sales to industrial customers and apply the proceeds to whatever subsidies it likes. This may be more awkward than the present arrangement, in which a state commission may attune its rate rulings to the price elasticity of each purchasing firm. But to say that is only to say that the present arrangement allows states to employ extraordinarily ad hoc means to finance subsidy programs. *Panhandle* may well allow persistence in such practices. If it does not, it is hard to see anything in the NGA that guarantees states the right to use such means, especially where the constraining factor is a Commission rule adopted in fulfillment of its duty under the Natural Gas Act to assure that natural gas be sold "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest." *See Atlantic Rfg. Co. v. Public Service Comm'n*, 360 U.S. 378, 388 (1959).[36]

Third, in the event that bypass does occur despite the potential competitive responses of LDCs and state commissions, FERC argues that the commissions may protect the captive consumers by modifying rate designs so that LDC shareholders, rather than ratepayers, bear the consequences of LDC inability to handle competition. *See* J.A. 1260. Where the LDC can be shown to have lost the business through imprudent judgments, that authority seems indisputable. That may dispose of the lion's share of cases. The state commissions argue that under *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), they could not deny recovery of costs that were

[36] The quoted language, taken from the original version of NGA § 7(c), refers to prices for gas sold interstate for resale, but the purpose presumably also applies to the pricing of interstate gas transportation services.

prudently incurred. We do not think *Hope* so restrictive. If the investment was prudent when made, but the losses occurred because the LDC maintained an irrational rate design that drove away the industrial customers, it is hard to see anything in *Hope*'s modest constitutional requirements that would bar state commissions from curtailing return on investment thereby wasted. Of course the matter would be different if the state commission had forced the LDC to maintain the vulnerable rate structure.

We note in this connection that the Brief of Associated Gas Distributors contends both that the Commission has neglected its duty to protect consumers by "delegating" it to state commissions, Brief of Associated Gas Distributors at 15-16, and that it has intruded upon the regulatory jurisdiction of the states, *id.* at 33-35. The first arm of this paradoxical complaint seems to us to assume far too great a reach for FERC's obligations. The Natural Gas Act was adopted in order to fill a "regulatory gap" created by Supreme Court decisions finding the states without power, as a result of negative implications of the commerce clause, U.S. Const. Art. I, § 8, cl. 3, to regulate interstate sales at wholesale. *See* H. Rep. No. 709, 75th Cong., 1st Sess., 1-2 (1937) (citing *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924), and *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927)). The Commission fulfills its mission under the Act if it establishes conditions by which the gas arrives in the hands of consumers or LDCs on terms that conform to the Act. That consumers may later suffer because of regulatory decisions made by state commissions, acting pursuant to their lawful authority, evidences no "delegation" by FERC.

The claim of intrusion on state authority appears to derive from the view that FERC authorization of transportation under OEC will lead to transactions that sharply affect state interests but which the state is un-

likely to be able to control. The specific example offered is of gas purchased out of state by an industrial user and then transmitted through OEC facilities. Brief of Associated Gas Distributors at 35. The distributors argue that state regulation of such a sale may not be legal. They suggest that *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951), holding that the NGA left intact state authority to regulate direct *pipeline* sales to an industrial end user, might not encompass an end user's purchase of gas from an out-of-state supplier.

Thus the contention is that the OEC procedures may present a state with a dilemma. We remain uncertain why the possibility of this dilemma should be characterized as an intrusion into state authority. In any event, the entire problem turns upon application of *Panhandle* to a set of facts that is not before us. Accordingly, we find the claim too hypothetical for disposition in this context.

Finally, we note that the presumption created by the OEC procedures is rebuttable. We cannot know at this point precisely what will be necessary to persuade the Commission that application of the presumption is inappropriate. But the existence of that backstop confirms our judgment that the OEC rules themselves can readily be applied in a manner consistent with the congressional purposes.

The Associated Gas Distributors claim that the OEC rules constitute a breach of the Commission's procedural obligation to ferret out relevant information even when no party draws its attention to them. They cite *Scenic Hudson Preservation Conference v. FPC*, 354 F.2d 608, 619-22 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966), which faulted the Commission for failure to pursue a wide variety of issues that environmental intervenors had brought to its attention. The court said that the Commission had "an affirmative duty to inquire into and

consider all relevant facts." *Id.* at 620. This proposition seems unexceptionable but irrelevant. The Commission determined that in most instances compliance with the limited criteria would assure a properly certificable facility or service, and provided for intervention in individual cases where anyone thought otherwise. Further, the issues not directly addressed in the initial criteria—notably, impact on competitors—are precisely the ones that are likely to trigger intervention. Under these circumstances, the procedures seem likely to assure an adequate vetting of all relevant and persuasive contentions.[37]

2. *Unsupported assumptions.*

The state commissions argue strenuously that the Commission has made an unwarranted assumption that under its OEC rules the pipeline will bear all the risks of a venture. The commissions point to rules allowing the applicant to charge a reservation fee for firm transportation. *See* § 157.103(d)(3). Such a charge of course involves risk-sharing *with the particular customer* who arranges for the service. But that form of risk-sharing seems wholly compatible with the Commission's fundamental reasoning: no risk is shifted onto any natural gas consumer against its will.

Many LDCs argue that the Commission has wrongly assumed that LDCs have the capacity to compete with pipelines for industrial customers on an equal footing. They point specifically to the LDCs' being subject to

[37] ANR Pipeline Company and Colorado Interstate Gas Company object to 18 C.F.R. § 157.103(d)(4), which provides that a pipeline offering OEC service may never decrease the units projected for ratemaking purposes below those projected in the original filing. They say that this defies standard principles of ratemaking, under which projections are altered to fit changed circumstances in order to prevent unlawful impairment of the regulated firm's capital. At least where the service is initiated under special rules promulgated clearly in advance, and seeking to mimic market constraints on firm behavior, we see no illegality.

legal service obligations (including duties to continue service even to customers that fail to pay their bills) and to restrictions on selective discounts.

We find no basis for believing that the Commission acted on false premises. The existence of service obligations alone does not distingish LDCs from pipelines. Both are subject to them; the pipelines' are discussed in this opinion's section on CD modification. That some states may impose greater burdens on LDCs hardly seems a sufficient basis for the Commission to refrain from its efforts to stimulate the availability of a supply of gas at competitive prices. If states choose to require LDCs to continue service to non-paying customers, those states must address the consequences. They can extract the cost from price-inelastic customers, primarily the solvent residential consumers; they can seek to extract the cost from industrial customers, at the peril of driving them off the system; they can fund the expense out of tax revenue; they can use their power under *Panhandle* to thwart the possible bypass, accepting the economic consequence that their industrial gas users may be unable to compete with firms in other states. All of these choices may involve some pain—like all true choices. But that hardly requires the Commission to abandon its effort, required under the NGA, to facilitate the flow of competitively-priced gas into the hands of gas consumers everywhere.

3. *Alleged failures of reasoned decisionmaking.*

The state commissions fault the Commission for failing to explain the shift from a former policy against allowing bypass. Supporting its view of the existence of such a policy, the commissions cite three cases that may be so read. *See Panhandle Eastern Pipe Line Co.*, Opinion No. 539, 39 F.P.C. 581 (1968); *Panhandle Eastern Pipe Line Co.*, Opinion No. 274, 13 F.P.C. 301 (1954), *aff'd* 232 F.2d 467 (3d Cir. 1956), *cert. den.*, 352 U.S.

891 (1956); *Southern Natural Gas Co.*, 25 F.P.C. 925 (1961). While it is true that the Commission has not, so far as we can discover, explicitly addressed the fact of this policy change, its overall reasoning provides ample explanation for modifying the policy.

The only ground ever given by the Commission for any prior anti-bypass policy—so far as we are able to determine—was its concern over the wasteful construction of duplicative facilities. *See Southern Natural Gas Co.*, 25 F.P.C. 925, 927 (1961). In the absence of a mechanism for preventing such waste, the policy is quite understandable. In its deliberations leading to Order No. 436, however, the Commission believed it had discovered a mechanism for solving that problem, namely, its risk-to-applicant rules. As we believe the Commission adequately justified its view that this form of certification would prevent the waste that the NGA's certification procedure sought to avoid, the Commission was not obliged to supplement the discussion by express consideration of the demise of its former policy.

VII. Miscellaneous Arguments

In addition to the broad attacks on Order No. 436 discussed above, the parties raise a number of relatively minor concerns.[38]

A. *Pipeline Sales Service Issues.*

A number of parties assert that FERC acted unlawfully in promulgating Order No. 436 without addressing various problems presented by pipeline sales service. The challenged omissions include: failure to completely bar minimum commodity bills (Brief of Columbia Gas Transmission Corp.); refusal to extend Order No. 436 to the transportation component of sales service (Brief of Peo-

[38] Those challenges not discussed in the opinion appear to us duplicative of others or frivolous and are dismissed.

ples Gas Light & Coke Co. and North Shore Gas Co.); failure to eliminate sole supplier provisions from pipeline sales tariffs (Brief of Central Illinois Light Co.).

As the Notice of Proposed Rulemaking made clear from the start, however, FERC intended Order No. 436 to be a comprehensive resolution only of transportation issues. In order to accomplish its goal of uncoupling transportation services from sales service effectively and in conformity with this court's holdings in the *MPC* cases, FERC addressed certain issues presented by sales service, notably CD conversion/reduction and the producer-pipeline purchase contracts. As we noted above, consideration of these issues was in all likelihood essential to FERC's task. Whenever possible, however, FERC has left sales issues for resolution outside of Order No. 436. This necessarily causes a certain incompleteness. But all natural gas issues are related to each other. That the web is seamless does not require an agency to reweave the whole whenever it reweaves a part. An agency is entitled to the highest deference in deciding priorities among issues, including the sequence and grouping in which it tackles them. *Cf. Heckler v. Chaney*, 470 U.S. 821, 831-32 (1985). We see no abuse of discretion in FERC's decisions to exclude the specified items from this page of its agenda.

B. *Notice Provisions.*

The Industrial End User Group objects to the notice and protest provisions applicable to § 7 transportation, 18 C.F.R. § 284.223, contrasting them with the far less onerous reporting requirements applicable to § 311 transportation, 18 C.F.R. §§ 284.106, 284.126. The Group argues that the discrepancy constitutes an unjustifiable discrimination, thus violating the Commission's statutory mandate and its stated purposes in embarking on the rulemaking. The distinction has bite for the industrial users because they are ineligible as direct beneficiaries

of § 311 transportation, which must be on behalf of an LDC or another pipeline.

We agree with FERC that there is both factual and legal support for the distinction. As FERC notes, petitioners' main objection is that such provisions make it more difficult to effect a bypass of an LDC, a situation FERC regards as meriting special scrutiny. The industrial users suggest that even on that basis no special notice is needed, for, they say, the gas will be transported either (1) to an existing direct customer or through an LDC, in which case no injury occurs, or (2) through a new connection, the construction of which would require Commission approval under § 7. But we do not understand these to encompass the universe of possible cases. An industrial user now supplied in part by a pipeline and in part by an LDC, for example, might shift away from reliance on the LDC and towards gas carried under a § 7 blanket certificate.

Moreover, the Commission in the rulemaking called attention to the value of fulfilling § 311's purpose of integrating the formerly segregated interstate and intrastate markets. J.A. 1225-26. Though articulated in a different context, the point supports less stringent rules for § 311 transportation. In § 311 Congress gave FERC broad authority to prescribe terms of transportation thereunder; it surely did not contemplate that FERC would use this authority to duplicate the regulatory scheme in place under the NGA, including its elaborate certification mechanism. *See* NGPA § 601(a)(2), 15 U.S.C. § 3431(a)(2) (1982) (Commission's NGA jurisdiction not to apply to transportation provided under § 311). The distinction drawn by the Commission is completely congruent with the one drawn by Congress in the two statutes.

C. *Transportation Policies.*

The Industrial End User Group also argues that FERC acted unreasonably in refusing to require pipelines not

electing to operate under Order No. 436 to publish their transportation policies in their tariffs. This issue is currently pending in an individual rate case now on review before the Commission from an administrative law judge's initial decision, *Transcontinental Gas Pipe Line Corp.*, 33 F.E.R.C. ¶ 63,035 (1985). The Group has not met the heavy burden of establishing the inadequacy of resolution in that forum. *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294-95 (1974).

D. *Construction of Facilities for Use in § 311 Transportation.*

Maryland People's Counsel asserts that Order No. 436 violates the NGA by leaving in place a prior regulation making clear that construction of facilities for use solely in providing § 311 transportation does not require § 7 certification. *See* 18 C.F.R. § 284.3(c) ("The [NGA] shall not apply to facilities utilized solely for transportation authorized by section 311(a) . . . ."). The crux of MPC's argument is that Order No. 436 expands § 311 transportation to the point where it is indistinguishable from § 7 transportation. Relying on legislative history indicating that Congress adopted § 7 in order to assure that consumers were protected from having to bear the costs of uneconomic construction, MPC contends that FERC must, in effect, extend the construction certification requirements of § 7 to § 311.

MPC's claim turns on the premise that Order No. 436 makes § 311 transportation a clone of transportation under § 7. We find this exaggerated. As Congress specified, § 311 transportation is limited to transportation on behalf of an LDC or a pipeline. Other petitioners call our attention to instances where that requirement appears to be fulfilled more in name than reality.[39] We

[39] The only elaboration the rule provides on the exact nexus required to satisfy the "on behalf of" standard is a statement that physical receipt is not necessary, but that the gas must be transported "for [the] account" of the benefited entity. J.A. 504-05 (reaffirming Order No. 46, 44 Fed. Reg. 52,179, 52,180 (1979)).

are told that in one case the contact with an LDC consists only of transportation through a six-foot stretch of pipe. Brief of Southern Indiana Gas & Elec. Co. at 13. Despite this episode, we do not believe that petitioners have shown a sufficient identity between § 311 and § 7 transportation to call FERC's judgment into question.[40] First, we are shown no evidence that § 311 transportation frequently—much less uniformly—pivots on a merely nominal connection with an LDC or other pipeline. Second, § 7(h) gives the holder of a § 7 certificate a power of eminent domain to acquire right-of-way to implement the Commission-approved plan; no such power accompanies authorization under § 311.

Thus, MPC would have us order the Commission to graft regulatory burdens mentioned only in the NGA onto § 311 merely because transportation under the two sections overlaps to some degree. This Congress did not intend; in the NGPA it declined to require a system of certification akin to that of § 7. Congress clearly recognized that consumer protection purposes can be achieved without control over entry. It selected for § 311 transportation a system paralleling its choice for oil pipeline: control over price but not entry. *See* NGPA § 311(a)(1)(B), 15 U.S.C. § 3371(a)(1)(B) (1982) (providing power over rates for service); 42 U.S.C. § 7172(b) (1982) (transferring to FERC regulatory power to establish rates and charges of oil pipelines). Congress underscored this distinction in NGPA § 601(a)(2), providing that transportation in interstate commerce under § 311 shall not trigger the Commission's NGA jurisdiction. This seems an unequivocal expression of intent that NGPA regulation should not replicate the burdens of the NGA.

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[40] In this connection we note that it is the practical effect of the "on behalf of" distinction that prompts the Industrial End User Group's objection to the more exacting notice provisions applicable to § 7 transportation.

E. *Grandfathering Decisions.*

In Order No. 436 FERC grandfathered a number of existing transportation arrangements for varying periods of time. These are attacked as too short or too long, or as being unjustified in comparison to the treatment of other arrangements.

All grandfathering decisions necessarily involve a trade-off between the values of stability on one side and of promptly securing a new rule's benefits on the other. FERC undoubtedly has power to make such adjustments; no petitioner questions it. Although FERC must exercise the power in a reasoned manner, such exercises are "necessarily arbitrary to some extent." *Capital Cities Communications, Inc. v. FCC*, 554 F.2d 1135, 1139 (D.C. Cir. 1976).

Michigan Consolidated Gas Co. ("MichCon") complains that the Commission's decision to grandfather blanket certificates previously authorized under § 311 and § 7 is an unreasoned one. It attacks both the decision to grandfather these transactions at all and the duration of the exemptions, which in the case of some § 7 certificates can run as long as 10 years from their start (the latest of which presumably originated shorty before promulgation of Order No. 436). Most acutely, MichCon argues that termination of these arrangements will not interrupt anyone's supply of gas. As the pipelines are more than able to satisfy any displaced sales from their supplies, the functional effect is merely to provide the presently-favored parties continued access to low-priced gas and to increase the probability that others will not secure such access. (The grandfathered authorizations tend to relax the pressure on pipelines to accept Order No. 436.) FERC conceded as much in rejecting the high-priority users' pleas for a permanent exemption. J.A. 506-07 ("there is no need to retain special procedures for a limited group of shippers"). So far as appears, however, FERC grandfathered these transactions with no

more than references to the desirability of a smooth transition to a new order, J.A. 273, to the reliance the parties placed on this transportation, J.A. 491-95, and to the authorized duration of the transactions and the need to avoid undue infringement on them, J.A. 1183.

These phrases do not seem to us to meet the modest standard implicit in the concept of reasoned decisionmaking. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 42-43 (1983). Thanks to the delays of the legal process (for which we acknowledge our share of responsibility), the grandfathering that expires October 9, 1987 is nearly moot and scarcely worth mentioning. Matters are different for transactions whose unlawfulness is extended into the mid-1990s. Perhaps there are rare enough, or involve so little volume, that the grandfathering will only trivially encourage pipeline resistance to the concept of nondiscrimination. Or perhaps the equities of the participants are stronger than appear. We cannot, however, "discern the path" by which the Commission has reconciled such grandfathering to its acknowledged mandate to stamp out discrimination. *Cf. Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285-86 (1974).

The intrastate pipelines attack from the other side, challenging FERC's failure to preserve all preexisting § 311 authorizations for their full authorized terms. Order No. 436 permits previously authorized § 311 transactions to continue until the earlier of their expiration or two years after the Order's effective date. The two-year grandfather period allows previously authorized § 311 transactions to come to a natural end, as FERC generally limited such transactions to two-year terms. 18 C.F.R. § 284.102(b)(1)(i) (pre-Order No. 436 version). In some instances, however, FERC provided for longer terms, *see id.* § 284.102(b)(2); the two-year grandfathering limit will cut some of these short. The petitioners contrast this with FERC's decision to grandfather existing § 7 certificates for their full terms.

There are two elements to the intrastate pipelines' attack on FERC's distinction between § 311 and § 7 grandfathering. First, they implicitly attack the existence of any line between the two at all, and here we cannot agree. In imposing the two-year ceiling on these § 311 extensions, FERC relied on its regulation, adopted at the outset of § 311 authorization, expressly making such certificates subject to prospective change. *See* Order No. 46, 44 Fed. Reg. 52,179, 52,181-82 (1979) (codified in pertinent part at 18 C.F.R. § 284.5); J.A. 1180-81. In its brief (though not in the rulemaking itself) the Commission contrasts that explicit warning with its absence in the § 7 context, suggesting greater likelihood of justifiable reliance in the latter. We think the point strong enough to explain non-identical treatment.

Insofar as the intrastate pipelines challenge the size of the discrepancy in treatment, we must agree. Above we found inadequate FERC's explanation for allowing the continuation of § 7 transportation for five- and ten-year terms. The discrepancy in treatment of § 311 authorizations deepens our mystification.

We can find no merit in petitioner Tenneco's lament that the Commission did nothing to allow continuation of the sales underlying the SMPs invalidated in *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) (*"MPC I"*). The entire thesis of *MPC I* was that the Commission had failed to assure that transportation for those purposes did not unduly discriminate. Order No. 436 is the Commission's answer. It allows those sales to continue, so long as the transportation is provided on a nondiscriminatory basis. We can detect no reason why the Commission should even consider finding an especially soft berth for the SMP gas. Such a view would nullify this court's time limit on continuation of the SMPs. *See Maryland People's Counsel v. FERC*, 768 F.2d 450, 455 (D.C. Cir. 1985) (*"MPC III"*).

F. *System Supply Limitation.*

Prior to Order No. 436 a FERC regulation limited § 311 transportation to gas delivered to an LDC, an intrastate pipeline, or an interstate pipeline for "its 'system supply for resale.'" J.A. 504 (referring to 18 C.F.R. 284.102(b)). As part of Order No. 436 FERC amended this regulation to permit transportation under § 311 in any case where it is "on behalf of" an intrastate pipeline or LDC, J.A. 505, thus incorporating the standards of the statute itself, NGPA § 311(a)(1)(A), 15 U.S.C. § 3371(a)(1)(A) (1982). Southern Indiana Gas and Electric Company contends that this change impermissibly opens "the way for interstate pipelines to invade the core markets of LDCs without prior FERC approval or the approval of the state regulatory commission." Brief of Southern Indiana at 12.[41] As noted above, it points to a case where the LDC on whose behalf the gas is transported itself carries the gas for only six feet. *Id.* at 13. Southern Indiana argues that elimination of the test is a "perversion" of § 311 because it will enable pipelines to bypass an LDC.

We disagree with Southern Indiana's contention that § 311 was "expressly intended to benefit LDCs." *Id.* The purpose of § 311—so far as we are able to discern—is not to bestow special benefits on any of the parties on

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[41] Laclede Gas Co. also attacks the elimination of the system supply requirement. The attack rests in part on the ground that this action will undermine the incremental pricing provisions of the NGPA, which we reject for the reasons given *infra* part VII.G. It further rests on an asserted negative inference from the Public Utilities Regulatory Policies Act, Pub. L. No. 95-617, § 608, 92 Stat. 3117 (1978), which was adopted the same day as the NGPA and amended § 7(c) to authorize the Commission to use a rulemaking to permit transportation for high-priority end users. That Congress especially authorized such an approach for high-priority users may reflect no more than that it thought of them as the most likely recipients of unbundled transportation; the case for applying *expressio unius est exclusio alterius* seems weak in this context.

whose behalf it authorizes transportation (*i.e.*, interstate pipelines and intrastate pipelines as well as LDCs), but to reduce the barriers between the interstate and intrastate gas markets. *See Public Service Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342 (1983); *Process Gas Consumers Group v. United States Dep't of Agric.*, 694 F.2d 728, 764 (D.C. Cir. 1981) (other portions vacated and reconsidered *en banc*, 694 F.2d 778 (D.C. Cir. 1982)), *cert. denied*, 461 U.S. 905 (1983). The many comments received on this issue, including those of LDCs, indicate that the system-supply test frustrated this purpose by placing LDCs at a severe disadvantage as against pipelines serving industrial end users directly under § 7 certificates. J.A. 504 & n.119. The Commission's decision to eliminate the test in favor of a rule more closely tracking the language of the statute—and thereby rendering the legal barrier far more permeable—was well within its powers.

G. *Transportation for Fuel-Switchable End Users.*

Laclede Gas Company contends that by adopting a program that permits fuel-switchable end users access to self-implementing transportation, FERC has impermissibly undermined the incremental pricing provisions of Title II of the NGPA, 15 U.S.C. §§ 3341-48 (1982). We reject the claim.

Congress sought to achieve two purposes in providing for incremental pricing. The first was to protect high-priority end users from a portion of NGPA-permitted price increases by shifting those costs to industrial users. *See Ohio Ass'n of Communuity Action Agencies v. FERC*, 654 F.2d 811, 813 (D.C. Cir. 1981). The second—the "market-ordering" purpose—was to maximize pipelines' incentive to bargain with producers. Congress recognized that the system of pricing tiers (low ceilings for old gas, higher ceilings for new and none for certain high-cost gas) could lead pipelines to bid more for new

or high-cost gas than their estimates of the long run market-clearing price. (Simplifying, pipelines would use the savings on old gas to finance purchases of new or high-cost gas; though paying supra-market prices for the latter, it would be able to recover the cost by selling at average prices. *See* National Regulatory Research Institute, *State Regulatory Options for Dealing with Natural Gas Wellhead Price Deregulation* 40-51 (1983). *But see* Niskanen, *Natural Gas Price Controls: An Alternative View*, Regulation 46 (Nov./Dec. 1987).) Incremental pricing would supposedly cure this by forcing the pipelines to bid no more for high-cost or new gas than the price-elastic segment of the market would bear. *See, e.g.*, Rule Required Under Section 202 of the Natural Gas Policy Act; Incremental Pricing, 45 Fed. Reg. 31,622, 31,623 (1980); Natural Gas Policy Act; Incremental Pricing; Phase II, 48 Fed. Reg. 55,294, 55,295-96 (1983). The principle has largely collapsed. Falling oil prices have made it impossible to load any significant portion of NGPA-permitted increases onto fuel-switchable consumers. 48 Fed. Reg. at 55,296.[42]

Laclede's thesis is that elimination of the system supply test will facilitate industrial end users' efforts to purchase gas directly from producers rather than through pipelines or LDCs. This, it suggests, will evade the intent of Congress in establishing incremental pricing, as incremental pricing only operates on pricing by pipelines and LDCs, not on direct producer sales to end users.

Laclede's theory extrapolates far too much from the incremental pricing provisions. If accepted, it would seem

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[42] For December 1986, alternative fuel price ceilings ranged from a low of $1.23 in Washington to a high of $1.95 in Minnesota, Nebraska, North Dakota and South Dakota. *Alternative Fuel Price Ceilings by States, by Month*, Natural Gas Monthly 64 (Jan. 1987). For the same period, the pipelines' average cost for gas produced from producers was $2.16. *Selected National Average Natural Gas Prices*, Natural Gas Monthly 10 (Jan. 1987). Thus it appears impossible for the pipelines to apply a surcharge in today's market.

to require invalidation of all blanket-certificate transportation for users possibly subject to incremental pricing, perhaps even case-specific certification. Further, Order No. 436 constitutes in itself an alternative mechanism for achieving the purposes of incremental pricing. First, it will give LDCs direct access to wellhead market prices considerably lower than pipelines' embedded contract gas costs. *See supra* part I. Second, by affording all parties access to a competitive wellhead market it prevents pipelines from passing through—and therefore from bidding—prices exceeding their estimates of the long run market-clearing price. Where the Commission has devised methods for effecting Congress's goals in Title II of the NGPA, it would be extraordinary for a court to spin out a remote inference from those provisions to strike down a portion of its handiwork.

Moreover, Congress was deeply concerned lest incremental pricing cause fuel-switchable end users to bolt the system, exposing high-priority customers to higher prices as a result of load loss. *See Ohio Ass'n of Community Action Agencies v. FERC*, 654 F.2d at 821-22. Order No. 436 in general, and elimination of the system supply test in particular, respond to that interest. By promoting fuel-switchable end users' use of pipeline transportation service, they make it possible for captive customers to bear a smaller portion of the pipelines' fixed costs.

VIII. Conclusion

As a general matter we uphold the substance of Order No. 436 and the procedures the Commission employed in adopting it. However, we have found problems in a few of the Order's components and must remand the matter to FERC for further proceedings. We now summarize these defects briefly.

The CD adjustment conditions suffer from a want of both legal authority and reasoned decisionmaking. The problem with legal authority stems from the Commis-

sion's misplaced reliance on § 7(e); the lack of reasoned decisionmaking lies in its failure to trace the path that led it from the statutory authority and the facts to its adoption of the CD reduction option. On remand, FERC is free to attempt to remedy these problems. If, however, it elects to go forward with the Order without CD conversion, it must, of course, explain why it feels that such a condition is no longer necessary.

The Commission's decision not to take any affirmative action to solve the problems posed by the uneconomic producer-pipeline contracts also fails to meet the standards of reasoned decisionmaking. On remand, FERC must more convincingly address the magnitude of the problem and the adverse consequences likely to result from the nondiscriminatory excess and CD adjustment conditions. It is not our place to say whether FERC should take measures to shift these losses from where they now lie; we ask only that it explain its course.

Finally, FERC has failed to adequately explain some of its grandfathering decisions. Even though a certain amount of arbitrariness goes with this territory, the Commission must reveal a reasoned basis for its decisions.

The parts of Order No. 436 are interdependent. The nondiscriminatory access and CD adjustment provisions aggregate the pipelines' jeopardy from take-or-pay liability. When coupled with take-or-pay liability, those provisions may bring about a wasteful imbalance between pipeline sales and unbundled transportation service. Thus the Commission's apparent insouciance on take-or-pay taints the package. And CD adjustment, which the Commission has identified as essential to remedying problems deriving from the pipelines' market power, suffers from independent vulnerabilities. Accordingly, we vacate Order No. 436 and remand for further proceedings consistent with this opinion.

It is so ordered.

MIKVA, *Circuit Judge, concurring in the judgment in part and dissenting in part*: I join in most of the majority's conclusion about this massive and historic order. Unfortunately, even in the many instances in which I share the majority's judgments, I remain wary of endorsing the totality of its exposition and analysis, and therefore I concur in the results only. Certainly a case of this scope requires a judicial response of some length and care, and I commend the majority's devotion to that task. But the majority's exhaustive, scholarly investigation of the history, regulation, and inner workings of the natural gas industry is, I believe, dangerously overbroad. I am concerned that tucked within the opinion's labyrinthine treatment of the issues are loose language and stray observations that could be viewed to stand for the position of this court on a range of matters only peripherally before us in this case but that may be squarely presented in the future. I believe we would have better served these and future parties with a more concise exposition of the basis for each of our holdings today. In addition, I part company with the majority on the issue of the "optional expedited certificates," which I believe improperly impinge on the power of state commissions to ensure affordable rates for individual consumers.

Before detailing my one point of discord with the majority's conclusions, I summarize the points of agreement. I fully agree that the Commission has statutory authority under the NGA and the NGPA to impose the open-access requirements. I also agree that as currently written, the so-called "first-come, first-served" condition is far too inchoate to bind industry members; before the Commission can seek to enforce this condition, it must elaborate how it works in practice, and that explanation must pass judicial review. I also share the majority's view that there is no legal defect in the rate provisions of Order No. 436. And I agree with the court's disposition of the contract demand adjustment provisions: the

Commission chose to rely on faulty authority for implementing the CD conversion, and it failed to provide independent grounds for the CD reduction provision. On remand, FERC can attempt to correct both these inadequacies.

I share the majority's appraisal of the Commission's treatment of the take-or-pay issue. The Commission's decision to take no affirmative action to ease take-or-pay liabilities is especially questionable in view of the fact that Order No. 436 actually exacerbates the already acute problem in at least two ways. First, the nondiscriminatory access condition significantly weakens the pipelines' bargaining position vis-à-vis producers; it is fanciful to imagine that producers will agree to meaningful reforms in their take-or-pay contracts when they know that the pipelines must transport their gas in any event. Second, the CD adjustment provisions prevent the pipelines from enforcing contracts that would pass along at least some of the high costs of take-or-pay contracts to the local distribution companies (LDCs). Thus, the pipelines effectively get squeezed from both ends. The Commission's insouciance in the face of these circumstances, many of which it helped bring about, is inappropriate. On remand, the Commission has a number of options before it, but I believe these should not include doing nothing whatsoever to assuage the take-or-pay situation. To the extent the majority invites the Commission to opt again for inaction but simply employ different reasoning, I dissent from the suggestion. How best to apportion these spiraling take-or-pay liabilities among the different players in the industry is admittedly a delicate problem. But the Commission's decision to close its eyes and hope the problem will go away is no solution and should not be tolerated on remand.

Finally, I believe the majority's treatment of the optional expedited certification procedures unduly vitiates the ability of state commissions to provide for affordable

energy for their residents. These procedures will make it far easier for pipelines to "bypass" LDCs—the local utilities with whom most consumers deal directly—and sell gas directly to large industrial end users. As the majority points out, *maj. op.* at 106, the chief reason that LDCs are vulnerable to bypass is that they frequently are required to subsidize residential consumers by charging higher rates to these large industrial end users. State commissions impose such two-tiered rate structures in order to protect local consumers, many of whom otherwise would be hard-pressed to afford their most basic energy needs. This practice has a long existence in the public utility field, and there is nothing in federal law that prohibits it. By facilitating efforts to bypass LDCs, the Commission effectively has overriden the states' ability to make such policy choices. Industrial end users will now be able to leave the system and get cheaper gas from the bypassing pipeline, leaving captive residential consumers to pay a greater proportion of the LDC's fixed costs. Thus, with no express invocation of federal preemptive power, the Commission has prevented the state commissions from protecting affordable rates for local consumers, which is a quintessential example of a matter of essentially local concern that should be regulated locally. *See Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329, 333 (1951). This is why the state commissions were virtually uniform in urging the Commission to reconsider and in asking us to set aside this portion of Order No. 436. I believe the Commission, and now this court, too quickly dismissed these important concerns about intrusion into the states' sphere of authority and too casually disregarded the needs of the everyday consumer, whose energy bill is likely to increase dramatically as a result of this ill-considered provision. I believe also that the majority fails utterly to hold the Commission to its legal requirement of providing a reasoned explanation for its departure from its previous policy against bypass. *See*

Panhandle Eastern Pipe Line Co., Opinion No. 539, 39 F.P.C. 581 (1968). For these reasons, I dissent from that part of the court's opinion approving of the optional expedited certification provisions of Order No. 436.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman; A. G. Sousa and Charles G. Stalon.

Docket No. RM85-1-000 (Parts A-D)

REGULATION OF NATURAL GAS PIPELINES AFTER PARTIAL WELLHEAD DECONTROL

ORDER NO. 436

FINAL RULE

(Issued October 9, 1985)

* * * *

The natural gas industry has changed in fundamental ways over the nearly 50 years since the Natural Gas Act was adopted in 1938. The changes have been accelerated over the last seven years by the phased removal of wellhead price controls under the Congressionally-mandated schedule set out in the Natural Gas Policy Act of 1978.

In a nutshell, the single most important economic change has been that natural gas has become a separate and distinct economic commodity: distinct from oil, distinct from transportation, and distinct from storage and various load balancing services. Around the commodity has evolved a highly competitive and rapidly growing spot market, with a thriving infrastructure of brokers and marketers, electronic information exchange services,

and trade publications tracking price and market movements. Moreover, the Congressional decision in the NGPA to remove both price (NGPA § 121) and non-price (NGPA § 601(a)(1)) regulation over "first sales" of most natural gas—whether in interstate or intrastate commerce—has meant that these supplies of gas can now generally be sold by producers or marketers without the need for prior regulatory approval of market entry, market exit or price.

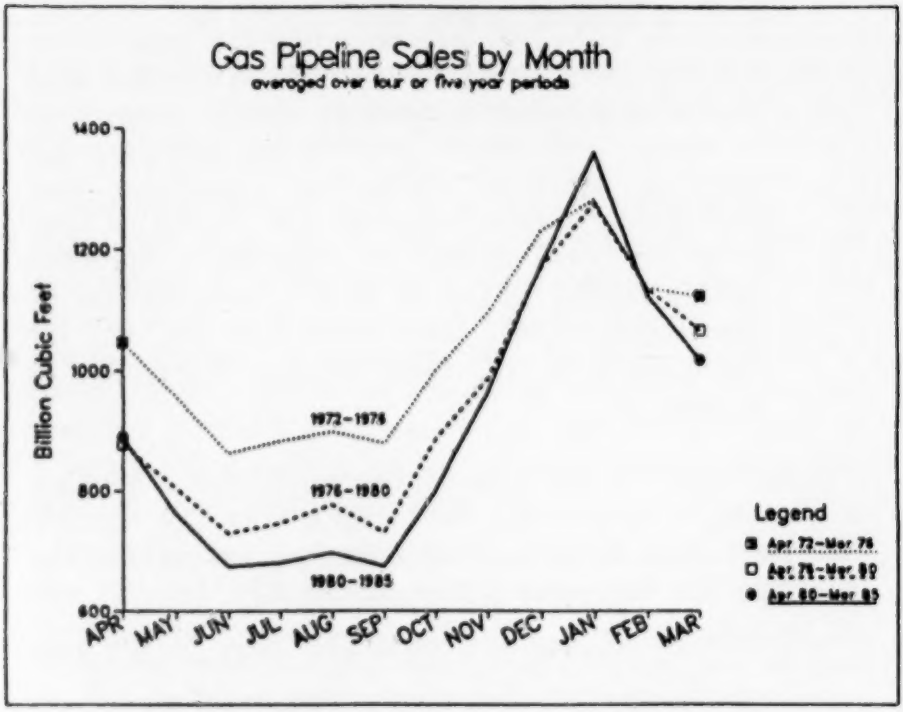
With regard to the availability of interstate pipeline *transportation*, the situation has also changed in sigificant ways. There are some geographic areas where there is but a single pipeline supplier, as was the case for the vast majority of markets in 1938. But in many other markets, there are two or more pipeline suppliers capable of serving a customer. The presence of pipeline-to-pipeline competition in these markets has radically altered the role of the Commission as well as the ability of utility-type regulation to tightly control regulated price levels.

Moreover, the maturing of the pipeline industry in recent decades has meant that there is now an interconnected nationwide pipeline grid. This enables increasingly efficient transportation transactions through backhauls, displacement and exchanges, enabling the "transportation" of a particular supply to a particular purchaser who is far removed from the supply and indeed may not even be directly physically connected with the field supply source. Thus, even where a pipeline is the only supplier to a given customer, that customer—given non-discriminatory access to the transportation service and proper rate treatment for all pipelines—has access to supplies of the *commodity* located in virtually any producing area in the Nation. Conversely, a producer of gas can now—given the same non-discriminatory access to the *transportation* grid—seek markets for his gas virtually anywhere in the Nation. As is demonstrated later,

this is not economic theory but bustling commercial reality.

Finally, there is the question of capacity. While it is true that pipelines generally continue to be fairly fully utilized during peak period operations, total deliveries through their systems have fallen sharply from the 1972-1973 period. This is illustrated in Chart I below.

Chart I



Source: FERC Form 11's.

This phenomenon has been reflected in lower annual load factors for interstate pipelines and higher *unit* costs of providing service. It has also meant a significant increase in the amount of capacity available for transportation outside of the periods of peak demand. The chart further indicates that pipeline utilization for sales during the peak winter period has remained high and

indeed has even increased. This indicates that firm capacity is generally being utilized on peak by those customers who have contracted for (or "booked") such service.

In short, the Commission is confronted with:

(1) a generally competitive market in the *commodity* of natural gas, most of which has been removed by Congress from all federal regulation as to market entry, exit and price, although such regulation has been retained by Congress over substantial amounts of gas; and

(2) a highly integrated *transportation* network, highly monopolistic in some markets, fairly competitive in others; over which Congress has generally determined to retain utility-type regulation over market entry, exit and price; but for which Congress has also allowed an alternative approach (under NGPA § 311) in which there may be no restrictions as to market entry and exit, but for which Congress expressly retained regulation as to rates.

* * * *

Since 1982, the Commission has considered a number of alternative approaches for dealing with the changes that have been becoming increasingly apparent in the industry. For example, we have considered:

- setting new, just and reasonable rates for old gas;
- establishing pipeline supply "cut-back" plans;
- eliminating minimum commodity bills;
- modifying the PGA regulations; and
- encouraging broader access to pipeline transportation for others.

The first two options focus on the wellhead. Under the first, the Commission would raise the price of old gas under NGPA sections 104, 106(a) and 109 to "just and

reasonable" levels. All aspects of this approach were aired in a Notice of Inquiry commenced in April of 1982 in Docket No. RM82-26.[18] The advantages of such an approach are that it would provide increased incentives for development of lower cost gas resources and would mitigate the distortions created by full rolled-in pricing in combination with the "cushion" of "old age." It would put increased downwards pressure on spot prices, however, and on the price of all above-average priced gas supplies. It could also involve the Commission in a most intimate way in determining the "proper" supply mix as between old and new gas. In effect the exercise of such power involves the concomitant responsibility of setting rates for the commodity that are neither too high nor too low.

The experience of 1954 to 1978 speaks eloquently to the difficulties faced by an independent economic regulatory commission in attempting to discharge that responsibility. It is the Commission's tentative judgment that Congress, through its decisions to ultimately decontrol all natural gas supplies (as old gas is depleted) determined that the workably competitive wellhead market would do a better job of setting such rates for the commodity than would a utility regulatory body.

Much of the discussion in the comments on Part D of the May 30 NOPR repeats the comment and argument received in response to the 1982 NOI in Docket No. RM82-26. For example, the Indicated Producers stressed the importance of continuing rolled-in pricing and called for action to raise the price for old gas. Similarly, their 1982 comments asserted that shortages could be expected in the not too distant future unless action was taken expeditiously to raise old gas prices.[19] The California Public Utilities Commission, on the other hand, in their 1982 comments, called for an end to full rolled-in pricing and the institution of a form of separate pricing of all old and new gas.[20] We anticipate that there will be a

more refined analysis of these issues in response to our request for supplemental comments on the revised Part D.

With regard to the second basic approach, beginning in 1983, a number of interstate pipelines, distributors and state commissions of major downstream gas consuming states began urging the Commission to establish gas "cut-back" plans for interstate pipeline. In essence, they proposed for the Commission to order the pipelines as to which gas supplies should be taken and in which order. A list of these filings is attached as Exhibit R.

In many respects this option represents the "flip side" of the old gas proposal. Like it, the "cut-back" plan approach would involve the Commission ultimately in many aspects of natural gas production decisions. It would substitute the Commission's judgment for that of the commercial parties on such issues as which supplies of gas should be taken by a pipeline in managing its portfolio of gas purchase agreements.

But unlike the old gas proposal, the cut-back approach would lay the predicate for pipelines to assert to producers that supervening governmental action relieved the purchaser of all liability for breach of contracts that would otherwise exist. It would thus also raise extremely serious questions regarding the ability of private parties in the gas production industry to rely on private contracts as a tool for structuring basic economic relationships.

The potential effect of the Commission pursuing this option thus could well have been, by essentially a stroke of the pen, to void thousands of gas purchase agreements nationwide and to declare worthless some $7 billion worth of contract damage claims which producers might otherwise pursue against interstate purchasers. Neither the legal nor the factual basis for potentially voiding billions of dollars in freely negotiated contracts was made clear in the filings made with the Commission. In addition, a

determination that effectively abrogated non NGA-jurisdictional wellhead contracts would run directly counter to the Congressional directives in the NGPA that progressively removed federal regulation of producer-pipeline transactions, and which expressly allowed the free operation of those contracts where below any applicable maximum lawful prices prescribed by statute. See NGPA § 101(b)(9). See also NGPA § 601(c). Accordingly, the Commission has declined to pursue this path.

Moreover, the Commission has sought to make it crystal clear that *nowhere* in the final rules, including in the bilateral CD reduction and conversion options, has the Commission abrogated any contracts nor created a regulatory framework predicated on any unilateral contract abrogation. In short, while the Commission has the power to abrogate NGA jurisdictional contracts where required by public interest considerations, we have not invoked that power in these rules and revised proposed rules.

* * * *

b. *Condition producer access to interstate transportation on requirement that they waive contractual rights under take-or-pay provisions.*

Comments

Just as some commenters argued for conditioning distributor access, so at the other end of the pipeline, many (but not all) interstate pipelines urge the Commission to condition access by producers. These commenters assert that the Commission has the authority to require producers to waive contractual rights under the take-or-pay provisions of existing contracts as a condition to obtaining non-discriminatory transportation. They further assert that the exercise of such authority is reasonable to enhance the pipelines' bargaining leverage in renegotiating contracts with producers.[44]

Commission Response

As with the request to restrict access to non-discriminatory transportation at the distribution end of the pipeline, so the Commission declines to restrict access to only certain producers. If transportation is to be available to the public on an equal and non-discriminatory basis, we cannot allow some shippers to be "more equal" than others.

In addition, for gas that has been removed from the Commission's NGA jurisdiction, there is a serious question as to whether the Commission has the authority to require a non-jurisdictional party to give up a valid contractual right as a condition to obtaining service. At the August hearing, a number of pipeline representatives expressed the opinion that such a course of action was a "close question," [45] or one to which a "definitive answer" could not be given.[46]

This uncertainty is reinforced by the court cases defining the limits of the Commission authority over natural gas production. See *e.g. Shell Oil Co. v. FPC*, 566 F.2d 536 (5th Cir. 1978) (reversing FPC Policy Statement regarding "prudent operator" standard), and *Pennzoil v. FERC*, 645 F.2d 360, 380-82 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) (holding that FERC lacks the power to even interpret gas purchase agreements between producers and pipelines for the sale of gas which has been removed from NGA jurisdiction).

It is one thing for the Commission to exercise its conditioning authority over regulated natural-gas companies to require them to provide access to shippers on a non-discriminatory basis. It is quite another to *deny* access to some shippers unless they agree to take action which is beyond our power to compel.

We also note that some pipelines continue to make progress in renegotiating their contracts with producers while others have been able to renegotiate much of their take-or-pay exposure, particularly for past periods.[47] For

example, while the potential take-or-pay liability for pipelines as a group has been estimated at $7-10 billion, actual prepayments in rate base have been far smaller. See Exhibit O. Moreover, actual prepayments in rate base in July of 1985 were over $100 million *lower* than in December of 1982. (Exhibit O.)

In addition, as noted in Table C-1, over $470 million in take-or-pay liability has been bought out for about $80 million in amounts sought to be recovered through filings with the Commission. We also note the repeated statements in the comments [48] that negotiations remain active in this area and that the Commission's proposed "safe harbor" rule has slowed that process rather than encouraging it. It is mainly for this reason that we have determined not to promulgate rules relating to such buyouts.

Accordingly, under these circumstances and given the fact that conditioning access would run completely counter to the whole idea of opening up the transmission grid on a non-discriminatory basis, the Commission declines to condition producer access as suggested.

* * * *

A number of commenters are adamant that responsibility for the costs of buying out take-or-pay obligations rests upon the customers that caused the pipeline to incur the obligation. They argue that the pipelines procured gas supplies for the benefit of their existing customers and are experiencing the present take-or-pay problems due to efforts to augment supply and meet their service obligations.[21]

3. *Commission response.*

a. *Decision not to promulgate Part B.*

We continue to believe that current and future take-or-pay obligations could possibly impede development of a more competitive gas market. In our April 10, 1985 State-

ment of Policy we responded to the information obtained through the Notice of Inquiry and our own observations of the gas market. We delineated the basic approach we intended to adopt toward solving the take-or-pay problem. As the comments to the NOPR point out, many producers and pipelines are currently renegotiating contracts under the guidance of the Policy Statement.

All segments of the industry responded to this portion of the rule. While virtually all commenters agree that take-or-pay obligations remain a problem for the industry, they are clearly unhappy with the safe harbor proposal as an additional means to resolve it. Many feel it is unworkable, or inadequate. Others are concerned that it will hinder, or even halt, the contract renegotiation that is underway between pipelines and producers. Many fault the requirements for eligibility as too rigid or mechanistic. Finally, many commenters urge us not to implement the proposed safe harbor rule, or to maintain the status quo.

As we stated briefly in the beginning of this section the imposition of a generic rule to handle take-or-pay buyouts at this time will not improve the take-or-pay problem and may actually aggravate the situation. In particular, we have no wish to upset current renegotiations. Therefore, in light of the many concerns raised by the written comments and at the public hearing, we will not promulgate Part B as proposed. Instead, and as requested by a number of commenters, we reaffirm our April 1985 Policy Statement. We shall clarify that those guidelines also apply to settlements of future take-or-pay obligations.

We note that pipelines have been successful in buying out past incurred take-or-pay liabilities in a number of instances. See Table C-1 below.

Table C-1

The list below shows costs of "bought out" take-or-pay sought by pipelines as of September 30, 1985, with references to Docket No., date of filing, amount sought, and amount of liability bought out.[1]

Pipeline Co.	Docket No.	Date of Filing	Amount Sought	Amount of Liability Bought out
ANR Pipeline Company	TA85-2-48	3/29/85	12,818,499	$ 64,092,495
Northern Natural Gas Company	RP82-71	4/26/82	2,700,000	13,500,000
Tennessee Gas Pipeline Company	TA85-1-9-001	11/30/84	4,436,757	22,183,785
Panhandle Eastern Pipe Line Company		—	13,000,000 [2]	45,000,000
Trunkline Gas Company	RP83-93 *et al.*	6/15/83	33,219,751 [3]	166,098,755
United Gas Pipe Line Company	RP72-133 (TA85-2-11)		[4]	
Prebuild (Northwest Alaskan Pipeline Co.)	RP85-6	10/16/84	5,400,000	48,400,000
Sea Robin Pipeline Company	RP85-167-000	6/28/85	9,186,000	62,000,000

[1] According to published reports, Columbia Gas Transmission has proposed buy-outs to producers totalling some $800 million dollars as part of an overall approach to regain its competitive position in the market for natural gas sales.

[2] Company has not filed to recover this amount.

[3] Amount included in settlement pending in the Commission.

[4] None, except payments made to Northwest Alaskan Pipeline Co.

These arrangements appear to have provided the parties the greatest flexibility to deal with some particularly difficult contractual problems. Accordingly, we have determined that the proven course at the present time is to take no substantive action in this area.

* * * *

EXHIBIT O

Gas Prepayments as of 12-31-82
Which are Included in Current Rates

Particulars	Volumes (Mcf)	Amount
Arkansas-Louisiana	3,021,818	$ 3,548,250
Cities Service Gas Company	29,000,000	11,000,000
Colorado Interstate Gas Company	16,092,314	28,857,519
Columbia Gas Transmission	4,666,200	9,513,699
El Paso Natural Gas Company	31,907,321	9,744,970
Kansas-Nebraska Natural Gas	3,983,607	4,033,467
Michigan Wisconsin Pipeline Company	118,000,000	193,624,176
Natural Gas Pipeline of America	117,000,000	174,000,000
Northern Natural Gas Company	36,243,572	75,770,715
Northwest Pipeline Company	6,483,908	10,420,072
Panhandle Eastern Pipeline Company	4,300,000	1,800,000
Southern Natural Gas Company	56,000,000	35,000,000
Tennessee Gas Transmission	19,368,456	71,993,696
Transco Gas Pipeline Company	43,821,352	70,006,064
Transwestern Pipeline Company	435,506	716,660
Trunkline Gas Company	5,400,000	1,700,000
Total Major Pipelines		$701,729,288
Other Pipelines Companies [1]		610,642
Total		$702,339,930

[1] Others include Southwest Gas Corp. $594,000 and Western Gas Transmission $16,642.

Source: Tab A of letter dated January 27, 1983 to Chairman Philip R. Sharp, House Subcommittee on Fossil and Synthetic Fuels, Committee on Energy and Commerce, from Chairman C. M. Butler III, Federal Energy Regulatory Commission.

The major interstate pipeline companies listed below do not have gas prepayments under take-or-pay obligations. The companies designated by footnote [2] are only gas transporters and those designated by footnote [3] are purchasers of gas from other interstate pipelines which would not be directly affected by gas prepayments under take-or-pay obligations.

Algonquin Gas Transmission Company [3]
Columbia Gulf Transmission Company [2]
Consolidated Gas Supply Corporation
East Tennessee Natural Gas Company [3]
Florida Gas Transmission Company [2]
Great Lakes Gas Transmission Company [2]
Midwestern Gas Transmission Company [3]
Mississippi River Transmission Corporation
Overthrust Pipeline Company [2]
Ozark Gas Transmission System [2]
Pacific Gas Transmission Company [2]
Pacific Interstate Transmission Company [2]
Sea Robin Pipeline Company [2]
Stingray Pipeline Company [2]
Texas Eastern Transmission Corporation
Texas Gas Transmission Corporation
Trailblazer Pipeline Company [2]
United Gas Pipe Line Company

ACTUAL TAKE-OR-PAY PREPAYMENTS of 23 Natural Gas Pipeline Companies Included in Rate Base

NAME	1983	1984
	($)	($)
ANR Pipeline Company	125,500,000	122,512,589
Arkansas Louisiana Gas Company	920,392	920,392
Colorado Interstate Gas Company	29,482,251	29,482,251
Columbia Gas Transmission Corp.	9,513,699	33,728,564 [1]
Consolidated Gas Supply Corp.	None	None
El Paso Natural Gas Company	6,707,287	6,707,287
Florida Gas Transmission Company	None	None
KN Energy, Inc.	4,033,467	4,033,467
Natural Gas Pipeline of America	43,961,769	43,961,769
Northern Natural Gas Company	74,494,574	74,494,574
Northwest Central Pipeline Corp.	None	None
Northwest Pipeline Corp.	10,420,072	10,420,072
Panhandle Eastern Pipe Line Co.	2,466,229	2,466,229
Sea Robin Pipeline Company	None	None
Southern Natural Gas Company	40,000,000	40,000,000
Tennessee Gas Pipeline Company	104,144,698	104,144,698
Texas Eastern Transmission Corp.	None	None
Texas Gas Transmission Corp.	None	None
Transcontinental Gas Pipe Line Corp.	93,731,122	110,802,018
Transwestern Pipeline Company	889,784	889,784
Trunkline Gas Company	38,269,533	38,259,533
United Gas Pipe Line Company	None	None
Mississippi River Transmission Corp.	42,809	42,809
Total	584,577,686 [2]	622,866,036 [2]

[1] Amount subject to refund effective 11-1-84.

[2] These are totals included in rate base sometime during 1983 and 1984. Therefore, they are not identical to the year end balances.

Source: Table included in Question 3(a) of letter dated April 15, 1985 to Chairman John D. Dingell, House Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, from Chairman Raymond J. O'Connor, Federal Energy Regulatory Commission.

ACTUAL TAKE-OR-PAY PREPAYMENTS of 23 Natural Gas Pipeline Companies Included in Rate Base

NAME	Updated Through July 31,1985
	($)
ANR Pipeline Company	$ 81,956,789
Arkansas Louisiana Gas Company	920,392
Colorado Interstate Gas Company	29,482,251
Columbia Gas Transmission Corp.	33,728,564 [1]
Consolidated Gas Supply Corp.	None
El Paso Natural Gas Company	7,327,298 [1]
Florida Gas Transmission Company	None
KN Energy, Inc.	6,209,388
Natural Gas Pipeline of America	43,961,769
Northern Natural Gas Company	74,494,574
Northwest Central Pipeline Corp.	None
Northwest Pipeline Corp.	5,500,000
Panhandle Eastern Pipe Line Co.	2,466,229
Sea Robin Pipeline Company	None
Southern Natural Gas Company	40,000,000
Tennessee Gas Pipeline Company	104,144,698
Texas Eastern Transmission Corp.	6,085,231
Texas Gas Transmission Corp.	None
Transcontinental Gas Pipe Line Corp.	110,802,018
Transwestern Pipeline Company	889,784
Trunkline Gas Company	38,259,533
United Gas Pipe Line Company	None
Mississippi River Transmission Corp.	42,809
Total	$586,271,371

[1] Amount if rates were based on a cost of service, but rates were based on a dollar settlement.

Source: Filings with the Federal Energy Regulatory Commission.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[18 C.F.R. Parts 2, 157, 284, and 375]

Before Commissioners: Raymond J. O'Connor, Chairman; A. G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

Docket Nos. RM85-1-100 through -003, -006 through 009, -011 through -038, -040 through -046, -048 through -071, -073 through -100, -102 through -125, -127 through -133, and -136
(Parts A-C)

REGULATION OF NATURAL GAS PIPELINES AFTER PARTIAL WELLHEAD DECONTROL

ORDER NO. 436-A

ORDER GRANTING IN PART AND DENYING IN PART APPLICATIONS FOR REHEARING, DENYING PETITION FOR STAY, AND GRANTING CLARIFICATION

(Issued December 12, 1985)

* * * *

The majority of pipeline and local distribution company applicants allege error in the failure of the Commission to condition producer access to non-discriminatory transportation on take-or-pay relief.

In the alternative, these applicants assert that Order No. 436 is arbitrary and capricious to the extent it provides for non-discriminatory access and CD reduction/conversion conditions without at the same time "resolving" the liability of pipelines under take-or-pay clauses in their so-called "problem" contracts with producers.

This is error, applicants say, because non-discriminatory access and CD reduction/conversion would expose pipelines to displacement of their own gas sales by gas bought directly in the field. In turn, they say, displacement of their own gas sales by gas transportation would increase the pipelines' take-or-pay liability with their producers for gas not taken under long-term contracts. Thus, they conclude, Order No. 436 does not adequately address this take-or-pay exposure and, therefore, is arbitrary and capricious.

A fundamental criticism of Order No. 436 made by virtually all interstate pipelines and by many of their customers is that the Commission has not dealt in the desired way with non-market responsive contracts between producers and pipelines. The criticism was put succinctly by the American Gas Association (AGA) (at 4):

> The issue is really bargaining power. The Commission is decreasing pipeline bargaining power, but increasing producer bargaining leverage by requiring pipelines to transport unconditionally for producers and by allowing unilateral producer abandonments under new section 2.77.

AGA further summarized the criticism of a number of companies[21] when it asserted (at 8) that:

> The non-discriminatory access provisions of new transportation sections 284.8(b) and 284.9(b), plus new section 2.77 on expedited abandonment, take away a pipeline's only tools for renegotiating these contracts.

All this means is that the company management must evaluate its business options. A pipeline may determine that certain of its existing business arrangements make participation in the new rules unwise or undesirable. The pipeline might wish, prior to commiting to the new rules, to alter any of a number of its existing business arrangements, including, to give but a few examples, the extent of its leveraged capital structure, the extent of its non-pipeline business interests or its existing contracts with producers. Nothing in Order No. 436 precludes a company's management from deferring participation until after these existing arrangements are modified.

In essence, these applicants are asserting that their "primary" or "only" tool for modifying contracts with producers is the ability to deny access to interstate transportation or to utilize the abandonment procedures under a Federal law to deny a producer the ability to move gas to market.

The Commission rejects these assertions concerning the effect of Order No. 436, and furthermore finds that condi-

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[21] *See also, e.g.*, applications of Northwest Pipeline Company, at 20 (pipeline access to transportation systems is really a pipeline's only trading card in seeking to renegotiate producer contracts); Tennessee Gas Transmission, at 6 (offering of transportation services in exchange for contractual concessions are the pipeline's "primary bargaining leverage against the producer"); and Natural Gas Pipe Line Company of America, at 17 (it is imperative for FERC to assist pipelines by providing them "trading chips" in dealing with producers, including conditioning producers' access to the interstate system).

tioning producer access on take-or-pay relief would be inconsistent with the non-discrimination requirements of both Order No. 436 and the Natural Gas Act.

It is obvious that pipelines have been successfully using section 311 and end-user transportation to offset declines which have already occurred in their gas sales.[22] It is also clear that local distribution companies, the prime users of self-implementing transportation services, look on such services as an opportunity to supplement, not replace, the security of their agreements with pipelines for firm sales services at times of peak demand. In other words, LDCs look on gas transportation as one tool to supplement their on-peak firm sales revenues with revenues from interruptible sales to off-peak users.

The reason for this is made obvious by the comments filed in this docket by the AGA. AGA demonstrated that the decline in gas sales demand between 1980 and 1985 is not due to reductions in *peak* demand but to decline in *off-peak* demand by industrial users. This is confirmed by data filed with the Commission by pipelines in FERC Form No. 16. The Form No. 16 data indicates that the sales load factors of most interstate pipelines have declined since 1980 and are at historically low levels.[23]

If LDCs exercise their option to convert or reduce firm sales service at times of peak demand, the Commission considers it more likely that they will either convert to firm transportation on the same pipeline, or else free up underutilized capacity under uneconomic CDs for use by other customers on the same pipeline. In either case, the

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[22] *See* "Voluntary Carriage Through Midyear 1985," Interstate Natural Gas Association of America (November 1985) at 1-3 ("Strong transportation growth offset sales declines during the second quarter of 1985. . . . This increase has occurred despite sizable declines in the pipelines' traditional sales business.").

[23] *See* Comments of AGA at 23, Attachment A. *See also* Final Rule, 50 Fed. Reg. at 42,413 (Oct. 8, 1985).

pipeline may actually increase throughput and, therefore, gain the net benefits of spreading its fixed costs over greater units of gas service.

In the situation where an LDC actually displaces the pipeline's own system supply gas, the Commission believes that the pipeline's revenues from sales may not necessarily decline and may in fact increase. This is because the LDC is unlikely to switch to transportation unless it can obtain gas supplies cheaper than the pipeline's own system supply. To that extent, the pipeline will be competing with itself as both merchant and transporter, and therefore will seek to adjust its gas purchasing practices so as to lower its weighted average cost of gas to all customers. If it does so, it stands to gain additional sales revenues overall, as it competes with other pipelines and other fuel sources for new customers.

However, in the unlikely case that a pipeline is unable or unwilling to seek to compete for its own sales customers who switch to transportation, the Commission rejects the assertion that the pipeline would necessarily bear the risk of increased take-or-pay liability under its contracts with producers.

As Order No. 436 demonstrated at Exhibit O, take-or-pay prepayments included by pipelines in rate base have remained stable or declined slightly between 1982 and 1985, despite the nearly 200 percent increase in pipeline transportation for LDCs and end users, and the continuing decline in pipeline sales during the same period. Although take-or-pay prepayments are in most cases less than a pipeline's potential take-or-pay liability, such prepayments do indicate the actual experience of the industry over the last few years. This actual data should be considered in contrast with various theoretical projections of such potential liability.

In addition, the Commission makes clear here what it intended in Order No. 436: nothing in Order 436, includ-

ing the non-discriminatory access and CD reduction/conversion conditions, is intended to affect the rights of parties to gas supply contracts between pipelines and their suppliers, nor to affect the existing jurisdiction of state and local agencies over the production and conservation of natural gas. Thus, to the extent an LDC or end-user contracts with pipelines for transportation services under Order No. 436, nothing in Order No. 436 is intended to abridge the rights and obligations regarding take-or-pay liabilities under contracts between those pipelines and their suppliers.

To the extent these rights and obligations are renegotiated or become the subject of litigation, the non-discriminatory access and CD reduction/conversion conditions are not intended to affect such renegotiations or litigation. To the extent a pipeline in fact incurs additional take-or-pay liability due to transportation services under Order No. 436, nothing in Order No. 436 is intended to preclude the Commission from determining the appropriate allocation of revenue responsibility among the pipeline and its customers in an individual rate case filed to reflect the adjustments in sales and transportation service. Thus, Order No. 436 leaves to individual rate cases the determination of whether a pipeline, or its customers, or both, will bear any risks or revenue responsibility for actual take-or-pay expenditures.

Finally, the Commission rejects the argument that Order No. 436 fails to "adequately deal" with take-or-pay problems. Part B of Order No. 436 reaffirms the April 10, 1985, Statement of Policy issued by the Commission on take-or-pay "buy-outs" negotiated by pipelines and producers. Part B was adopted in the final rule in lieu of the more specific presumption of prudence for certain specified take-or-pay settlement costs proposed in the Notice of Proposed Rulemaking. This more specific proposal was unanimously rejected *as inadequate* by the overwhelming majority of interstate pipeline commenters and producer and LDC commenters as well.

For this reason, the Commission in Part B of the final rule reaffirmed the take-or-pay policy statement and adopted a new policy statement on expedited producer abandonment. This new policy statement provides that the Commission will expeditiously review unopposed applications for abandonment of gas subject to take-or-pay relief or substantially reduced takes. In the latter case, even where take-or-pay relief is not an express element of the abandonment application, the abandonment and sale of the gas elsewhere may make available to former pipeline purchasers the usual contract remedies against the producer for mitigation of damages, including mitigation of take-or-pay obligations.

The Commission notes with interest the study on high-cost gas contracts appended to AGA's petition for rehearing. This appendix indicates the bulk of high-cost "problem" contracts without "market-outs" may be those entered into prior to 1982 involving offshore gas regulated under NGPA section 102. To this extent, Order No. 436 as well as a recent order of the Commission [24] indicate that producers of such gas will not be granted blanket transportation authority independent of that provided by pipelines on a voluntary basis under Order No. 436. Producers of such gas may be able to obtain blanket authority to abandon their service obligations to pipelines and sell such gas elsewhere. However, voluntary release of such gas may be the subject of take-or-pay negotiations. In fact, Order No. 436 positively encourages on-going and potentially successful private negotiations between the parties regarding their take-or-pay rights and obligations, such as the recent contract settlement between Columbia and its customers and suppliers.[25]

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[24] Tenneco Oil Co., *et al.*, Order Permitting and Approving Limited Term Abandonments and Granting Certificates, Docket No. CI85-633-000, *et al.* (Oct. 29, 1985).

[25] *See also* "Columbia Gas Says 4 Suppliers Reduced Prices," *Wall Street Journal*, November 12, 1985.

Finally, regardless of whether these three assertions by petitioners are true or not, the Commission declines to condition producer access for another reason: conditioning producer access on take-or-pay relief would be patently inconsistent with the non-discriminatory access requirements of Order No. 436 as well as sections 4 and 5 of the NGA.

Where a willing producer-seller and a willing buyer agree to a contract for the sale of gas, it would be unduly discriminatory for a pipeline to refuse to provide transportation service for the gas under Order No. 436, merely because the producer and pipeline cannot agree on take-or-pay relief in another contract. Such a refusal would discriminate not only against the producer-seller, but also against the willing buyer who has never been a party to the take-or-pay contract in the first place.

Moreover, nothing preclude any gas shipper, whether end-user, LDC, or independent broker, from negotiating *on its own behalf* a condition in a "self-help" gas sales contract which would require the producer-seller to grant take-or-pay relief to the shipper's pipeline supplier before the shipper takes delivery of the gas. This is especially true where the shipper is attempting to purchase gas supplies that are currently under contract to a pipeline, but are not being taken because of the pipeline's reduced need for those gas supplies.

For all these reasons, the Commission declines to condition producer access to non-discriminatory transportation on take-or-pay relief.

* * * *

2. *Unilateral Reduction in Obligations by Pipelines*

The final rule permits customers to reduce or convert to transportation their sales contract entitlement. Some applicants believe pipelines should have a corresponding

right to unilaterally reduce their contractual obligations to producers. Florida Gas (at p. 17) argues that even though a pipeline may have kept its gas supply and sales in balance, exercise of the CD reduction/conversion option could create take-or-pay liability. Similarly, Consolidated Natural (at p. 7) foresees declining sales, but no relief from existing minimum bill obligations.

Transco (at p. 7) asserts that granting open access at the distribution end—by permitting distributors to abrogate their contracts with pipelines—is totally inconsistent with precluding pipelines from a concomitant modification of their producer contracts.

The Commission does not believe that a right to reduce obligations under producer contracts necessarily flows from its decision to permit customers to reduce or convert their contract demands. The Commission instituted the CD reduction/conversion option to allow customers and purchasers to obtain access to other supply sources and to choose the type of service best suited to their individual needs. Because customers will have more options, pipelines will have more incentive to keep sales and transportation services competitive and to engage in continued renegotiation of "problem" take-or-pay contracts. Indeed, a customer's CD reduction may not increase a pipeline's take-or-pay obligations because the customer may only be bringing its CD in line with its new market requirements and would not have bought additional gas under any circumstances.

The contracts under which pipelines purchase gas from producers are straightforward commercial agreements, not utility-type "service agreements." A reduction in the volumetric level of a pipeline's service agreement with its customers may or may not result in a change in the rate for providing the reduced service depending on the disposition of the pipeline's subsequent rate case. A reduction in the volume of a take-or-pay clause in a producer's

contract to sell gas to the pipeline, however, would simply reduce the minimum dollar obligation of the pipeline; the producer cannot file a subsequent rate case to seek to collect the same level of revenues over a smaller number of sales units. In short, the analogy drawn between pipeline-LDC and producer-pipeline contracts confuses utility service agreements under a regimen of cost based rates with commercial contracts for the sale and delivery of a commodity.

The Commission denies these rehearing requests because it does not have jurisdiction over many of the producer-pipeline contracts at issue. It would be inequitable to allow pipelines to reduce their takes only under contracts still subject to the Commission's NGA jurisdiction, particularly because many of the problem contracts are not subject to the Commission's jurisdiction. Finally, as it indicated in Order No. 436, the Commission is convinced that the April 10, 1985, Statement of Policy provides an adequate framework within which pipelines may address the problem of take-or-pay liabilities. Moreover, many pipelines have made progress in renegotiating their contracts and substantial liabilities have been settled.

* * * *

Section 284.7(d) imposes numerous rate conditions on pipelines transporting natural gas under Subparts B, G, or H of Part 284. This section provides that the rates must be volumetric, one-part rates that recover costs allocated to the service on the basis of projected units of service, except to the extent a reservation fee is permitted by § 284.8(d) for firm transportation; separately identify the cost component attributable to transportation, gathering, and storage; and reasonably reflect any material variation in the cost of providing service due to the time at which the service is provided and the distance over which it is provided.

Several commenters argue that rates designed consistent with these conditions will not enable pipelines to recover their costs. Several of these commenters—El Paso (at pp. 13-14), UDC (at pp. 44-52), Transwestern (at pp. 17-20)—contend that the solution to this problem is to eliminate the rate conditions and provide that the rates will be established on a case-by-case basis.

The Commission sees no merit in this argument. The rate conditions in § 284.7(d) simply establish the basic ratemaking framework. The actual rate levels will be set on a case-by-case basis. 50 Fed. Reg. at 42,448. Moreover, as stated in Order No. 436, one of the critical elements to be considered in setting rates for transportation under Subparts B, G, and H is to design rates that will allow the pipeline to recover its costs plus a fair return. Finally, the essence of § 284.7(d) is that rates must be designed so that the pipeline will recover the costs allocated to the service if it transports the volumes (the "projected units of service") used to design the rates. This is exactly the same method the Commission uses to design rates for other pipeline services, such as firm sales. No tenable argument can be made that this method does not permit pipelines to recover their costs plus a fair return.

Nor does the Commission see any merit to the arguments when the specifics of § 284.7(d) are considered. El Paso (at pp. 9-10) and UDC (at p. 48) argue that § 284.7(d) will not permit pipelines to recover their costs because § 284.7(d)(3)(i) requires the rates to reasonably reflect any material variation in the cost of providing the service due to "whether the service is provided during a peak period or an off-peak period." This is so, El Paso argues, because the rate for transportation during the peak period will be higher than the rate for sales services, which generally do not differentiate between peak and off-peak periods. Hence the customers will tend to buy gas during the peak period. But during the off-

peak periods the transportation rate will be lower so that customers will transport rather than buy gas. The problem with this argument is that it assumes that all the fixed costs associated with providing self-implementing transportation will be allocated to the peak period.

The final regulations do not presuppose that all fixed costs will be allocated to the peak period. That will be determined in the rate case in light of the rate objectives of § 284.7(c) and other basic goals and elements of the rate design process, such as the necessity of designing rates that permit pipelines to recover their costs. *See* 50 Fed. Reg. at 42,447-48. Furthermore, nothing precludes a pipeline from using the rate objectives of § 284.7(c) when designing its sales rates.

El Paso and UDC also argue that pipelines will not recover their costs because the rate conditions require pipelines to offer "unbundled rates" for transportation while sales rates are not "unbundled." Section 284.7(d)(1) provides that the rates must "separately identify the cost components attributable to transportation, storage and gathering costs." To the extent certain services are not required for the transportation of gas, some of the costs can be avoided by pipeline. Other costs will have to be reallocated in rate proceedings, depending on the reasons for their incurrence. This does not mean that the pipelines will be unable to recover costs prudently incurred.

Finally, UDC argues (at pp. 44-95) that the pipelines will not recover their costs because the reservation fee does not "guarantee recovery of an appropriate level of fixed costs." Nothing in the statute requires us to guarantee the recovery of fixed costs. All that is required is that the pipeline be given the opportunity to recover its costs. *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942). The reservation fee provided by the regulations gives pipelines the opportunity to recover essentially the same level of transportation-related fixed costs

recovered in their sales demand rates. Indeed, if the maximum volumetric rate is collected for the projected units of service, the pipeline will recover its fixed costs even without charging a reservation fee. Accordingly, the Commission sees no reason to grant rehearing on this issue.

3. *Reservation Fees*

a. *Diminution of Risk to Pipelines*

APGA (at pp. 37-38) argues that no reservation fee should be permitted for firm transportation under subparts B, G, and H or for sales service. AGPA argues that this is necessary to place pipelines at risk. The Commission disagrees. First, the question of the appropriate method of developing rates for sales service is considerably beyond the scope of this rule. Second, the reservation fee pipelines may impose for firm transportation under subparts B, G, and H enables them to recover no more than the same portion of fixed costs recovered in their sales demand rates. It does not guarantee recovery of all fixed costs. Those costs remain at risk, depending on the level of throughput. *See* 50 Fed. Reg. at 42,471.

b. *Proposed Exemption for Small Sales Customers*

APGA (at p. 39) also argues that, if pipelines are permitted to impose a reservation fee, they should not be permitted to impose a reservation fee on a customer that converts from firm sales to transportation where the rate the customer paid for sales service was a one part rate. In short, AGPA argues that, if the customer did not pay a demand charge when it was a sales customer, it should not pay a reservation fee when it converts to firm transportation. The Commission disagrees. In Order No. 436, the Commisison decided pipelines should be permitted to impose a reservation fee for firm transportation to mini-

mize the possibility that, because of the non-discriminatory access condition, customers would "overbook" capacity. 50 Fed. Reg. at 42,449. Sales service is not subject to a non-discriminatory access condition. Consequently, the Commisison sees nothing in the fact that customers do not pay a demand charge for sales service to warrant exempting them from the reservation fee for self-implementing transportation. Moreover, the program is voluntary. If the customer is better off as a sales customer; it will remain a sales customer. If it is better off as a transportation customer, notwithstanding a reservation fee, it can exercise the option it prefers.

c. *Applicability to Intrastate Pipelines*

Producers Gas (at p. 8) seeks clarification of whether the permission that the rule gives to interstate pipelines to impose a reservation fee applies to intrastate pipelines. It does to the extent that the intrastate pipeline offers firm transportation subject to the non-discriminatory access condition in § 284.8 and that the total rate meets the fair and equitable standard. If a pipeline provides firm service in intrastate commerce and charges a reservation fee for that service that is consistent with the requirements of § 284.8(d), the pipeline may use that reservation fee for service provided under Subpart C. If the pipeline has no such reservation fee and seeks to impose a reservation fee for firm interstate service, it must, consistent with § 284.123(b)(2), file the reservation fee with the Commission and support it. *See* § 284.123(b).

4. *Cost Allocation Issues*

a. *Reasonableness of Allocating Between Peak and Off-Peak Periods*

Section 284.7(d)(3)(i) provides that rates must reasonably reflect any material variation in the cost of providing service due to whether the service is provided

during peak or off-peak periods. AGPA (at p. 44) argues that the term "off-peak period" should be construed in accordance with pre-existing cost classification and allocation precedents, such as *Atlantic Seaboard Corp.*, 11 FPC 43 (1952). APGA's point seems to be that in setting rates for self-implementing transportation the Commission should follow its past practice of allocating a substantial amount of fixed costs to off-peak periods.

The Commission is not adopting this clarification. Although the result of the ratemaking process may or may not be that substantial amounts of fixed costs will be allocated to the off-peak period, the Commission sees no reason to determine the result now. Instead, the question of how much of the pipeline's fixed costs are to be allocated to off-peak periods will be determined on a case-by-case basis in light of the rate objectives in § 284.7(c).

b. *Meaning of "Properly Allocated"*

Section 284.7(d)(4) provides that the rates for a transportation service provided under subparts B, G, or H must recover "solely those costs which are properly allocated to the service to which the rate applies." APGA (at pp. 45-57) argues that the Commisison should modify § 284.7(d)(4) to require pipelines to allocate storage, production, gathering, and "as billed" fixed costs to their firm transportation services on the same basis that these costs are allocated to their firm sales service.

The Commission declines to adopt this modification. The basic rule the Commission follows in allocating costs to sales service is to allocate to each service and each class of customers the costs the pipeline incurs in serving them. *See generally Columbia Gulf Transmission Co.*, Opinion No. 173, 23 FERC ¶ 61,396, at 61,850 (1983), *aff'd sub nom., City of Charlottesville v. FERC*, No. 83-2059 (D.C. Cir. Oct. 18, 1985). The Commisison intends no departure from that rule in allocating costs to transportation services. *See* 50 Fed. Reg. at 42,448. Hence the

general rule to be followed in allocating costs to transportation services will be the same as the rules followed in allocating costs to sales services. The consequence of this, however, may well be that the amounts and types of costs allocated to transportation services will differ from those allocated to sales service. For example, a pipeline may incur production costs to provide sales services, but it may not incur those costs to provide transportation services. Consistent with the general rule, the pipeline should therefore not allocate production costs to transportation. Accordingly, the Commission sees no basis for requiring pipelines to allocate to transportation services the same costs allocated to sales services. Instead, the costs to be allocated to transportation must be resolved, as they always have been, in individual rate cases.

5. *Selective Discounting*

a. *Legal Authority*

Among the rate conditions imposed on transportation performed under subparts B, G, and H is the requirement of § 284.7(d)(5)(i) that the rate schedule set forth a maximum rate and a minimum rate. A pipeline may then charge a customer the maximum rate, the minimum rate, or any rate in between. *See* § 284.7(d)(5)(ii).

AGPA (at pp. 47-67), Laclede (at pp. 12-14), NI-Gas (at pp. 22-30), Southern Indiana (at pp. 29-35), Ohio Association (at pp. 2-4), and IOGA (at pp. 2-3), oppose this aspect of the rate. Each argues that section 4(b) of the Natural Gas Act prohibits a pipeline from charging one customer one rate and another customer a different rate. The Commission disagrees.

In Order No. 436 the Commission reviewed the applicable law and precedents. It concluded that section 4(b) was not intended to prohibit pipelines from discounting its rates to its customers to meet competition. *See* 50 Fed. Reg. at 42,452.

None of the parties opposing § 284.7(d)(5)(ii) challenge the Commission's analysis of the statute's legislative history. Instead, they argue around the question. For example, APGA argues (at pp. 57-59) that allowing pipelines to discount their rates to particular customers to meet competition is inconsistent with the holding of the D.C. Circuit in *MPC II*, which is, APGA alleges, that the NGA requires the same rate to be charged to captive and non-captive customers. The problem with this argument is that the issue before the court was not whether the Commission could allow a pipeline to offer a discount to a particular customer to meet competition. The issue was whether the Commission could allow a pipeline to deny access to transportation (and therefore to the competitive nationwide market for gas supplies) to some customers. To be sure, there is language in the court's opinion, 761 F.2d at 784-85, that says the NGA requires pipelines to charge the same rate to captive and non-captive customers. But this language is in the section of the opinion in which the court is summarizing the petitioner's arguments. Nothing in the rest of the opinion suggests that the court was thereby adopting those arguments as its own statement of the law on an issue that was not then before it.

NI-Gas also argues (at pp. 25-27) that § 284.7(d)(5)(ii) is inconsistent with the D.C. Circuit's holding in *MPC II*. But NI-Gas' argument is that to permit pipelines to charge customers different rates for transportation amounts to allowing pipelines to discriminate among customers in terms of access to transportation. This is incorrect. The two situations are different. In the case before the court in *MPC II* the Commission had denied captive customers access to transportation. Here, by contrast, the Commission's regulations require pipelines to grant access to transportation to all customers willing to pay the just and reasonable rate.

NI-Gas (at pp. 28-30) and Laclede (at pp. 13-14) argue that permitting pipelines to offer a discount to a particular customer will remove the competitive pressure on producers to reduce the price of gas at the wellhead. But in Order No. 436 the Commission examined the impact that permitting pipelines to offer discounts to particular customers might have on wellhead prices. 50 Fed. Reg. at 42,454. The Commission concluded that permitting pipelines to discount selectively would likely have no effect on prices at the wellhead. The Commission sees nothing in the arguments of NI-Gas and Laclede that requires a different conclusion.

b. *Anticompetitive Effects*

APGA (at p. 47), Ohio Association, IOGA, and Southern Indiana (at p. 32) argue that permitting pipelines to discount selectively will have anticompetitive effects. For example, Southern Indiana argues that a pipeline could use § 284.7(d)(5)(ii) to charge the maximum rate to an LDC while charging an end-user, formerly served by the LDC, a discounted transportation rate, thereby imposing a price squeeze on the LDC. The problem with this argument is that it overlooks the fact that the conduct of a pipeline offering a discount to one customer but not to another is still subject to scrutiny under both the antitrust laws and sections 4 and 5 of the NGA. The Commission made that clear in Order No. 436. *See* 50 Fed. Reg. at 42,454.

Moreover, *both* rates are fully subject to the Commission's rate jurisdiction and full remedial powers. Hence, the situation is entirely distinguishable from the price squeeze issue as it arises under the Federal Power Act. *Cf., Mid-Tex Electric Cooperative v. FERC*, 773 F.2d 327, 355-56 (D.C. Cir. 1985) (sl. op., at pp. 58-59).

In short, all that Order No. 436 provides is that a pipeline offering a discount to one customer but not to

another is not by that mere fact engaging in unduly discriminatory conduct. It does not provide that a pipeline may engage in anticompetitive or unreasonable conduct or that the Commission will not take action to remedy unduly discriminating rates being charged. Accordingly, the Commission sees no reason to eliminate § 284.7(d)(5)(ii).

* * * *

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

AIR PRODUCTS AND CHEMICALS, INC., et al.,
ALGONQUIN GAS TRANSMISSION COMPANY,
ALABAMA-TENNESSEE NATURAL GAS COMPANY,
AMERICAN BAKERS ASSOCIATION,
AMERICAN GAS ASSOCIATION,
AMERICAN PUBLIC GAS ASSOCIATION,
AMERICAN PAPER INSTITUTE, INC.,
ARKLA, INC.,
AMOCO PRODUCTION COMPANY,
ARCO OIL AND GAS COMPANY,
ASHLAND EXPLORATION, INC.,
ARMSTRONG WORLD INDUSTRIES,
ASSOCIATED GAS DISTRIBUTORS,
ASSOCIATION OF TEXAS INTRASTATE
NATURAL GAS PIPELINES,
ATLANTA GAS LIGHT COMPANY,
BALTIMORE GAS AND ELECTRIC COMPANY,
BROOKLYN UNION GAS COMPANY,
CABOT CORPORATION,
CAROLINA UTILITY CUSTOMERS ASSOCIATION, INC.,
CASCADE NATURAL GAS CORPORATION,
CENTRL ILLINOIS LIGHT COMPANY,

CHAMPLIN PETROLEUM COMPANY,
CHEMICAL MANUFACTURERS ASSOCIATION,
CHEVRON U.S.A. INC.,
CITIES SERVICE OIL AND GAS CORPORATION,
CITIZENS ENERGY CORPORATION,
CITY OF WILCOX, ARIZONA and ARIZONA ELECTRIC
POWER COOPERATIVE, INC.,
COLUMBIA GAS DISTRIBUTION COMPANIES,
COLUMBIA GAS TRANSMISSION CORPORATION,
COLUMBIA NITROGEN CORPORATION AND NIPRO, INC.,
COMMONWEALTH OF KENTUCKY PUBLIC
SERVICE COMMISSION,
CONOCO, INC.,
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
CONSUMERS POWER COMPANY AND MICHIGAN GAS
STORAGE COMPANY,
DELHI GAS PIPELINE CORPORATION,
DEPARTMENT OF PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK,
DIAMOND SHAMROCK EXPLORATION COMPANY,
EL PASO NATURAL GAS COMPANY,
ENTEX, INC.,
EXXON CORPORATION,
FERTILIZER INSTITUTE,
FLORIDA GAS TRANSMISSION COMPANY,
FOOTHILLS PIPE LINES (YUKON) LTD.,
GAS DISTRIBUTORS INFORMATION SERVICE,
STATE OF LOUISIANA,
TENNECO OIL COMPANY,
TENNGASCO CORPORATION,
TEXAS EASTERN TRANSMISSION CORPORATION,
TEXACO, INC.,
TEXAS GAS EXPLORATION CORPORATION,
TEXAS GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
TRANSOK, INC.,
TRANSWESTERN PIPELINE COMPANY,

TRUNKLINE GAS COMPANY,
WEIRTON STEEL CORPORATION,
WESTCOAST TRANSMISSION COMPANY LIMITED,
WEST VIRGINIA CONSUMER ADVOCATE,
WISCONSIN POWER & LIGHT COMPANY,
UNION OIL COMPANY OF CALIFORNIA,
VALERO TRANSMISSION COMPANY,
UNITED DISTRIBUTION COMPANIES,
UGI CORPORATION,
KANSAS POWER AND LIGHT COMPANY,
STATE OF MICHIGAN AND MICHIGAN PUBLIC SERVICE COMMISSION,
SOUTH JERSEY GAS COMPANY,
WASHINGTON GAS LIGHT COMPANY,
ARIZONA PUBLIC SERVICE COMPANY,
SUN EXPLORATION AND PRODUCTION COMPANY,
BETHLEHEM STEEL CORPORATION,
Intervenors

AND CONSOLIDATED CASE NOS. 85-1812, 85-1813, 85-1818, 85-1821, 85-1830, 85-1836, 86-1001, 86-1006, 86-1007, 86-1008, 86-1016, 86-1017, 86-1018, 86-1019, 86-1020, 86-1022, 86-1023, 86-1024, 86-1029, 86-1030, 86-1031, 86-1032, 86-1034, 86-1035, 86-1036, 86-1038, 86-1042, 86-1046, 86-1047, 86-1048, 86-1049, 86-1050, 86-1051, 86-1053, 86-1054, 86-1055, 86-1056, 86-1063, 86-1066, 86-1067, 86-1076, 86-1081, 86-1083, 86-1085, 86-1086, 86-1087, 86-1088, 86-1089, 86-1090, 86-1092, 86-1094, 86-1095, 86-1097, 86-1098, 86-1099, 86-1100, 86-1102, 86-1103, 86-1153, 86-1154, 86-1155, 86-1226, 86-1235 and 86-1246

Petitions for Review of Orders of the
Federal Energy Regulatory Commission

[Filed June 23, 1987]

Before: MIKVA, BORK, and WILLIAMS, *Circuit Judges.*

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Energy Regulatory Commission, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the order of the Federal Energy Regulatory Commission under review herein is hereby vacated and these cases are remanded, in accordance with the Opinion for the Court filed herein this date.

Per Curiam

For The Court

/s/ George A. Fisher

George A. Fisher
Clerk

Date: June 23, 1987

Opinion for the Court filed by Circuit Judge Williams

Opinion concurring in the judgment in part and dissenting in part filed by Circuit Judge Mikva.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

AIR PRODUCTS and CHEMICALS, INC., et al.,
Intervenors

AND CONSOLIDATED CASE NOS. 85-1812 et al.

[Filed July 1, 1987]

Before: MIKVA, BORK, and WILLIAMS, *Circuit Judges.*

ORDER

It is ORDERED, by this Court, *sua sponte*, that the Opinion for the Court filed by Circuit Judge Williams on June 23, 1987 be, and hereby is, amended as follows:

Page 4, line 1, delete the argued date "1987" and insert in lieu thereof "1986"

Page 17, delete the first sentence and insert in lieu thereof "On October 9, 1985 the Federal Energy Regulatory Commission ("FERC" [1]) issued Order No. 436, 50 Fed. Reg. 42,408 (1985) (codified at scattered sections of 18 C.F.R.)."

Page 35, line 2, delete "capitioned" and insert in lieu thereof the word "captioned"

Page 50, line 4, delete "relience" and insert in lieu thereof the word "reliance"

Page 57, line 8, delete "(1943)" and insert in lieu thereof the date "(1944)"

Page 94, line 10, delete "ntaural" and insert in lieu thereof the word "natural".

Per Curiam

FOR THE COURT

/s/ George A. Fisher

George A. Fisher
Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS

v.

FEDERAL ENERGY REGULATORY COMMISSION

AIR PRODUCTS and CHEMICALS, INC., *et al.*,
Intervenors.

AND CONSOLIDATED CASE NOS. 85-1812 et al.

[Filed July 1, 1987]

Before: MIKVA, BORK and WILLIAMS, *Circuit Judges*

ORDER

It is ORDERED, by the Court, *sua sponte*, that the opinion of June 23, 1987, be, and the same hereby is, amended as follows:

At page 18, first full paragraph, line 6:

delete the word
record

and insert in lieu thereof the word
case

Per Curiam

FOR THE COURT:

GEORGE A. FISHER,
Clerk

By: /s/ ROBERT A. BONNER

Robert A. Bonner
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS, *et al.*

v.

FEDERAL ENERGY REGULATORY COMMISSION

AND CONSOLIDATED CASES

[Filed Sept. 15, 1987]

Before: WALD, *Chief Judge*; ROBINSON, MIKVA, EDWARDS, RUTH B. GINSBURG, BORK, STARR, SILBERMAN, BUCKLEY, WILLIAMS and D. H. GINSBURG, *Circuit Judges*

ORDER

The suggestions for rehearing *en banc* of Associated Gas Distributors, et al. and of joint petitioners American Public Gas Association, et al. have been circulated to the full Court. No member of the Court requested the taking of a vote thereon. Upon consideration of the foregoing, it is

ORDERED, by the Court *en banc*, that the suggestions are denied.

Per Curiam

FOR THE COURT:

GEORGE A. FISHER,
Clerk

By: /s/ ROBERT A. BONNER
Robert A. Bonner
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
United States Courthouse
333 Constitution Avenue, N.W.
Washington, D.C. 20001-2866

George A. Fisher
Clerk

General Information
(202) 535-3300

September 15, 1987

General Counsel
Federal Energy Regulatory Commission
Washington, DC 20426

Re: No. 85-1811 et al.–Associated Gas Distributors v. Federal Energy Regulatory Commission
(Orders 436 and 436 A,B,C,D 12-12-85)

Dear Sir:

Pursuant to the provisions of Rule 41(a) of the Federal Rules of Appellate Procedure, transmitted herewith, in lieu of formal mandate, is a copy of this Court's Opinion and a certified copy of the Judgment, both filed on June 23, 1987. Also enclosed is a certified copy of two amending orders, both filed on July 1, 1987.

Kindly acknowledge receipt on the enclosed extra copy of this letter.

Very truly yours,

GEORGE A. FISHER
Clerk

By: /s/ Denise Thomas
Deputy Clerk

Enclosures

cc: All Counsel (letter and judgment only).

APPENDIX D

Natural Gas Act:

Sec. 4, 15 U.S.C. § 717c

§ 717c. Rates and charges; schedules; suspension of new rates

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in

a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Sec. 5, 15 U.S.C. § 717d

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting

such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

Sec. 7, 15 U.S.C. § 717f

§ 717f. Construction, extension, or abandonment of facilities; certificate of convenience and necessity; condemnation proceedings

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or muni-

cipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physicial connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) (1) (A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas com-

pany or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) (1) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the pur-

pose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided*, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

Sec. 16, 15 U.S.C. § 717o

§ 717o. Administrative powers of Commission; rules, regulations, and orders

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend,

and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this chapter; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

Sec. 19, 15 U.S.C. § 717r

§ 717r. Rehearings; court review of orders

(a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for

rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclu-

sive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.

(c) The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

Natural Gas Policy Act of 1978:

§ 311, 15 U.S.C. § 3371

§ 3371. Authorization of certain sales and transportation

(a) Commission approval of transportation.—

(1) Interstate pipelines.—

(A) In general.—The Commission may, by rule or order, authorize any interstate pipeline to transport natural gas on behalf of—

(i) any intrastate pipeline; and

(ii) any local distribution company.

(B) Just and reasonable rates.—The rates and charges of any interstate pipeline with respect to any transportation authorized under subparagraph (A) shall be just and reasonable (within the meaning of the Natural Gas Act).

(2) Instrastate pipelines.—

(A) In general.—The Commission may, by rule or order, authorize any intrastate pipeline to transport natural gas on behalf of—

(i) any interstate pipeline; and

(ii) any local distribution company served by any interstate pipeline.

(B) Rates and charges.—

(i) Maximum fair and equitable price.—The rates and charges of any intrastate pipeline with respect to any transportation authorized under subparagraph (A), including any amount computed in accordance with the rule prescribed under clause (ii), shall be fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.

(ii) Commission Rule.—The Commission shall, by rule, establish the method

for calculating an amount necessary to—

(I) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, delivery, or similar service provided by such pipeline in connection with any transportation of natural gas authorized under subparagraph (A); and

(II) provide an opportunity for such pipeline to earn a reasonable profit on such services.

(b) Commission approval of sales.—

(1) In general.—The Commission may, by rule or order, authorize any intrastate pipeline to sell natural gas to—

(A) any interstate pipeline; and

(B) any local distribution company served by any interstate pipeline.

(2) Rates and charges.—

(A) Maximum fair and equitable price.—The rates and charges of any intrastate pipeline with respect to any sale of natural gas authorized under paragraph (1) shall be fair and equitable and may not exceed the sum of—

(i) such intrastate pipeline's weighted average acquisition cost of natural gas;

(ii) an amount, computed in accordance with the rule prescribed under subparagraph (B); and

(iii) any adjustment permitted under subparagraph (C).

(B) Commission rule.—The Commission shall, by rule, establish the method of calculating an amount necessary to—

(i) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, or delivery price provided by such pipeline in connection with any sale of natural gas authorized under paragraph (1); and

(ii) provide an opportunity for such pipeline to earn a reasonable profit on such services.

(C) Adjustment. —

(i) Application.—This subparagraph shall apply in any case in which, in order to deliver any volume of natural gas pursuant to any sale authorized under paragraph (1), any intrastate pipeline acquires quantities of natural gas under any existing contract, if—

(I) such intrastate pipeline acquires any volume of natural gas under such contract in excess of that which such pipeline would otherwise have acquired; and

(II) the price paid for such additional volume of natural gas acquired under such contract is greater than such pipeline's weighted average acquisition cost of natural gas, computed without regard

to the acquisition of such additional volume of natural gas.

(ii) Commission adjustment.—In any case to which this subparagraph applies, the Commission shall permit an adjustment to the maximum fair and equitable price provided under subparagraph (A) to increase the revenue to the intrastate pipeline under such sale by an amount determined by the Commission to be adequate to offset the additional cost incurred by such pipeline due to any increase in such pipeline's weighted average acquisition cost of natural gas.

(3) Limitation.—

(A) Two-year duration.—No authorization of any sale (or any extension thereof) under paragraph (1) may be for a period exceeding two years.

(B) Extension.—Any authorization of any sale under paragraph (1), and any extension of any such authorization under this subparagraph, may be extended by the Commission if such extension satisfies the requirements of this subsection.

(4) Adequacy of service to intrastate customers.—Any sale authorized under paragraph (1) shall be subject to interruption to the extent that natural gas subject to such sale is required to enable the intrastate pipeline involved to provide adequate service to such pipeline's customers at the time of such sale.

(5) Procedural requirements.—

(A) Affidavit.—Any application for authorization of any sale under paragraph (1)

shall be accompanied by an affidavit filed by the intrastate pipeline involved and setting forth—

(i) the identity of the interstate pipeline or local distribution company involved;

(ii) each point of delivery of the natural gas from the intrastate pipeline;

(iii) the estimated total and daily volumes of natural gas subject to such sale;

(iv) the price or prices of such volumes; and

(v) such other information as the Commisison may, by rule, require.

(B) Verification of compliance.—Any application for authorization of any sale under paragraph (1) shall be accompanied by a statement by the intrastate pipeline involved verifying by oath or affirmation that such sale, if authorized, would comply with all requirements applicable to such sale under this subsection and all terms and conditions established, by rule or order, by the Commission and applicable to such sale.

(6) Termination of sales.—

(A) Hearing.—Upon complaint of any interested person, or upon the Commission's own motion, the Commission shall, after affording an opportunity for oral presentation of views and arguments, terminate any sale

authorized under paragraph (1) if the Commission determines—

(i) such termination is required to enable the intrastate pipeline involved to provide adequate service to the customers of such pipeline at the time of such sale;

(ii) such sales involves the sale of natural gas acquired by the intrastate pipeline involved solely or primarily for the purpose of resale of such natural gas pursuant to a sale authorized under paragraph (1);

(iii) such sales violates any requirement of this subsection or any term or condition established, by rule or order, by the Commisison and applicable to such sale; or

(iv) such sale circumvents or violates any provision of this chapter.

(B) Suspension pending hearing.—Prior to any hearing or determination required under subparagraph (A), upon complaint of any interested person or upon the Commission's own motion, the Commission may suspend any sale authorized under paragraph (1) if the Commission finds that it is likely that the determinations described in subparagraph (A) will be made following the hearing required under subparagraph (A).

(C) Determination.—The determination of whether any interruption of any sale authorized under paragraph (1) is required under subparagraph (A) (i) shall be made

by the Commission without regard to the character of the use of natural gas by any customer of the intrastate pipeline involved.

(D) State intervention.—Any interested State may intervene as a matter of right in any proceeding before the Commission relating to any determination under this section.

(7) Disapproval of application.—The Commission shall disapprove any application for authorization of any sale under paragraph (1) if the Commission determines—

(A) such sale would impair the ability of the intrastate pipeline involved to provide adequate service to its customers at the time of such sale (without regard to the character of the use of natural gas by such customer);

(B) such sale would involve the sale of natural gas acquired by the intrastate pipeline involved solely or primarily for the purpose of resale of such natural gas pursuant to a sale authorized under paragraph (1);

(C) such sale would violate any requirement of this subsection or any term or condition established, by rule or order, by the Commission and applicable to such sale; or

(D) such sale would circumvent or violate any provision of this chapter.

(c) Terms and conditions.—Any authorization granted under this section shall be under such terms and conditions as the Commisison may prescribe.

§ 601, 15 U.S.C. § 3431

§ 3431. Coordination with Natural Gas Act

(a) Jurisdiction of Commission under Natural Gas Act.—

(1) Sales.——

(A) Natural gas not committed or dedicated.—For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) Committed or dedicated natural gas.—Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 3317(c)(1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312(c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

(C) Authorized sales or assignments.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 3362 (a) or 3371(b) of this title; or

(ii) pursuant to any assigned[1] authorized under section 3372(a) of this title.

(D) Natural-gas company.—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provision of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) Alaskan natural gas.—Subparagraph (B)(ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) Transportation.—

(A) Jurisdiction of the Commission.—For purposes of section 1(b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371(a) of this title.

(B) Natural-gas company.—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable.—

(1) Sales.—

(A) First sales.—Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 3362(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines.—For purposes of section 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 3372 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation.—For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not ex-

ceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges.—

(A) Allocation.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under Section 3363(h)(1) of this title.

(B) Transportation.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough.—

(1) Certificate may not be denied based upon price.—The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid.—For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount

paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

APPENDIX E

STATEMENT REQUIRED BY RULE 28.1

Pursuant to Rule 28.1, Petitioners list their parent companies, subsidiaries (other than wholly-owned subsidiaries) and affiliates.

AMOCO PRODUCTION COMPANY

Amoco Production Company is a wholly-owned subsidiary of Amoco Corporation. To the best knowledge of counsel, affiliates of Amoco Production Company that may have securities in the hands of the public in the United States or Canada are:

Amoco Australia Limited
Amoco Canada Petroleum Company, Ltd.
Amoco Company
Amoco Credit Corporation
Amoco Oil Holdings, S.A.
Amoco (U.K.) Exploration Company
Analog Devices, Inc.
Cetus Corporation
Cyprus Mines Corporation

APACHE CORPORATION

The subsidiaries and affiliates of Apache Corporation not wholly-owned are:

Nagasco, Inc.
Nagasco Gas Gathering Company of Oklahoma
Nagasco Marketing, Inc.

ARCO OIL AND GAS COMPANY

ARCO Oil and Gas Company is an affiliate of Atlantic Richfield Company. The non-wholly-owned subsidiaries of Atlantic Richfield Company are:

Alyeska Pipeline Service Company
Anamax Mining Company
ARCO Chemical Company
ARCO Solar (Europe) GmbH
ARCO Solar Nigeria Ltd.
Arcobrasil Participacoes e Investimentos Ltda.
Badger Pipeline Company
Black Lake Pipe Line Company
Blair Athol Coal Pty. Limited
Compania Minera Dos Republicos S.A. de C.V.
Compania Petrolera Carco
Colonial Pipeline Company
Cook Inlet Pipe Line Company
Curragh Coal Sales Co. Pty. Ltd.
Dixie Pipeline Company
East Texas Salt Water Disposal Company
85819 Canada Limited
Eisenhower Mining Company
FX Liquidation Corporation
Industrias Nacobre S.A. de C.V.
Iricon Agency Ltd.
Kenai Pipe Line Company
Kuparuk Transportation Company
Las Quintas Serenas Water Company
Logan Aluminum, Inc.
Nordisk Mineselskab A/S
Platte Pipe Line Company
Prince Consolidated Mining Company
Rodman, Inc.
Showa Arco Solar Far East Pte Ltd.
Showa Arco Solar KK

Sinclair Venezualan Oil Company
Smoke House Copper Mining Company
Tecumseh Pipe Line Company
Texas-New Mexico Pipe Line Company

ASHLAND EXPLORATION, INC.

Ashland Exploration, Inc. has the following parent companies, subsidiaries (except wholly-owned subsidiaries) and affiliates:

Arch Mineral Corporation
Ashland Coal, Inc.
Ashland Oil, Inc.
Establissement Locab
Super Mom's Kitchens, Inc.
B.V. Ashland-Suedchemie v/h Necof
CARBOGAL-Carbonos de Portugal S.A.R.L.
Datacare, Inc.
Gravecap, Inc.
Iberia Ashland Chemical S.A.
Locap, Inc.
Loop, Inc.
Malamine Chemicals, Inc.
Minnesota Pipe Line Company
Saudi Industrial Resins Limited
Tecumseh Pipe Line Company
United Carbon India Limited
Australian Carbon Black Pty. Ltd.
Malaysian Carbon Sdn. Bhd.
P.T. Indocarb
Negroven, S.A.
Applied Chemical Products (Pty) Ltd.
Applied Agricultural Products (Pty) Ltd.
Applied Foundry Products (Pty) Ltd.
Applied Industrial Products (Pty) Ltd.
Chematron Products (Pty) Ltda.
Ashland-Avebene
Ashland Croda Pty. Ltd.

Ashland de Mexico S.A. de C.V.
Ashland Resinas Sinteticas, Ltd.
Ashland-Suedchemic-Kernfest GmbH
Ashland-Suedchemic-Gremolith AG
Georg Hantos & Co. OGH
Kernfest-Webac, A.B.
Oleotecnica, S.A.
Medicine Bow Coal Company
Cumberland Materials, Inc.
Crescent Petroleum Company
Delmar Plaza Associates
500 Cary Corporation
Travelers Inns of Charlotte, Inc.
Travelers Inns of Winston-Salem, Inc.
Travelers Inns of Wytheville, Inc.
Resource Sciences-Arabia Ltd.
Resource Sciences Gulf Limited
Williams Brothers Iran Consulting Engineers
U.S. Felt Company
WICMAP Transport Pty. Ltd.
Williams Brothers Malaysia Sdn. Bhd.

CITIES SERVICE OIL AND GAS CORPORATION

Cities Service Oil and Gas Corporation is a wholly-owned subsidiary of Cities Service Company, which is in turn, a wholly-owned subsidiary of Occidental Petroleum Corporation. Its non-wholly-owned affiliates are:

Canadian Occidental of California, Inc.
IBP, Inc.

CONOCO INC.

Conoco Inc. is a wholly-owned subsidiary of E.I. Du Pont de Nemours and Company. The following is a list of affiliates of Conoco Inc. who are not wholly-owned by E.I. Du Pont de Nemours and Company.

Cit-Con Oil Corporation (Delaware)
Juliana Coal Co. (Partnership)
Coman I Limited (Partnership)
Coman II Limited (Partnership)
Coman III Limited (Partnership)
Conch L.N.G. (New Jersey)
Conoco Exploration, Ltd. (Partnership)
Continental Oil Limited (Partnership)
Conrhein Coal Co. (Partnership)
Cardinal River Coals, Ltd. (Alberta, Canada)
Harmar Coal Co. (Pennsylvania)
Tongue River Railroad (Partnership)
Oasis Oil Co. of Libya, Inc. (Delaware)
Colonial Pipeline Company (Delaware)
Milne Point Pipe Line Company (Delaware)
Dixie Pipeline Company (Delaware)
Explorer Pipeline Company (Delaware)
Lake Charles Pipe Line Company (Delaware)
Pioneer Pipe Line Company (Delaware)
Platte Pipe Line Company (Delaware)
Yellowstone Pipe Line Company (Delaware)
Jupiter Chemicals, Inc. (Delaware)
Kettleman North Dome Assoc. (California)
Petroleum Terminals, Inc. (Indiana)
Southern Facilities, Inc. (Delaware)
The Standard Shale Products Company (Colorado)
Neptune Bulk Terminals (Canada) Ltd.
Mathies Coal Co. (Pennsylvania)
Tongue River Moldings Inc. (Montana)
Seadock, Inc. (Texas)
Seaway Pipeline, Inc. (Delaware)
Long Beach Oil Development Company (Nevada)
Tidelands Royalty Trust (Texas)

EXXON CORPORATION

The following are affiliates and subsidiaries of Exxon Corporation. This list does not include wholly-owned subsidiaries, nor does it include companies with less than 5% Exxon ownership.

Abu Dhabi Petroleum Company Limited
Ace Polymer Co., Ltd.
Aditivos Orinoco, C.A.
Adria-Wien Pipeline Gesellschaft mit beschrankter Haftung
Aircraft Fuel Supply B.V.
Aishin Sekiyu K.K.
Alberta Products Pipe Line Ltd.
Al-Jubail Petrochemical Company
Altona Petrochemical Company Limited
Alyeska Pipeline Service Company
Andian National Corporation, Limited
Arabian American Oil Company
Aramco Overseas Company
Aramco Services Company
Asakawa Sekiyu K.K.
Asociacion Civil "Academy La Castellana"
Atlas Supply Company
Atlas Supply Company of Canada Limited
Australian Synthetic Rubber Company Limited
Aviation Services Saudi Arabia Limited
Awaji Gas Nenryo Kabushiki Kaisha
Azuma Sekiyu K.K.
BEB Erdgas und Erdol GmbH, Hannover
BT Asia Securities Limited
B.W.O.C., Inc.
Bangkok Aviation Fuel Services Limited
Banshu Ekika Gas K.K.
Bayerische Erdgasleitung G.m.b.H.
Beaverhill Resources Limited
Bel-Air Entreposage S.A.
BRIGITTA Erdgas und Erdol GmbH, Hannover

Bryan Woodbine Gathering Inc.
Building Products of Canada Limited
Byron Creek Collieries (1983) Limited
Carlew Inc.
Carnduff Gas Limited
Cary Chemicals Inc.
Castle Peak Power Company Limited
Champlain Oil Products Limited
Changi Airport Fuel Hydrant Installation Pte. Ltd.
Chuo Sekiyu Hanbai K.K.
Commercial Polymers Pty. Ltd.
Compagnie d'Etancheite Africaine en Cote d'Ivoire S.A.
Compania Minera Disputada de Las Condes S.A.
Comptoir Auxiliaire du Petrole
Comptoir Oxonnaxien des Combustibles (C.O.C.)
Computer Centrum Groningen B.V.
DFTG Deutsche Flussigerdgas Terminal GmbH
Daihatsu Sekiyu K.K.
Daiichi Kouyu K.K.
Demulsificantes Del Orinoco, C.A.
Depot Petrolier du Gresivaudan
Depots de Petrole Cotiers
Depots Petrolier de la Corse
Deudan-Holding GmbH
Deutsche Erdgas Transport G.m.b.H.
Deutsche Transalpine Oelleitung G.m.b.H.
Devon Estates Limited
Dixie Pipeline Company
Dukhan Service Company
E S F Limited
Eagle Kenso K.K.
East Japan Oil Development Company, Limited
East Texas Salt Water Disposal Company
Eastcoast Spill Response Inc.
Eiko Sekiyu K.K.
Elwerath Erdgas und Erdol GmbH, Hannover
Elwerath Erdol und Erdgas AG

Emirates Chemicals Company
Emori Sekiyu K.K.
Emsland-Erdolleitung G.m.b.H.
Energie Marketing Service GmbH (EMS)
Entrepot Petrolier de l'Aveyron (E.P.A.)
Entrepot Petrolier de Mulhouse (E.P.M.)
Erdgas-Verkaufs-Gesellschaft m.b.H.
Escuela Las Morochas, C.A.
Esso Chemical Alberta Limited
Esso Energie G.I.E.
Esso Exploration and Production Angola Inc.
Esso Malaysia Berhad
Esso of Canada Limited
Esso Resources Canada Limited
Esso Societe Anonyme Francaise
Esso Standard Tunisie S.A.
Establissements Cloarec
Exact Reisebyra A/S
Exxon Chemical Pakistan Limited
489061 Ontario Inc.
F. T. Giken Kabushiki Kaisha
Federated Pipe Lines Ltd.
Ferngas Nordbayern G.m.b.H.
Ferngas Salzgitter GmbH
Forjas de Colombia, S.A.
Fuji Kogyo K.K.
Gasunie Engineering B.V.
General Bussan K.K.
General Highway K.K.
General Petrochemical Industries Limited
General Sekiyu K.K.
General Sekiyu Okinawa Hanbai K.K.
General Sekiyu Overseas Ltd.
General Shipping Co. Ltd.
General Unyu Kabushiki Kaisha
Geobutane-Lavera
Gewerkschaft Brassert Erdol und Erdgas GmbH
Gewerkschaft Elwerath & Co. GmbH

Gewerkschaft Erdol-Raffinerie Deurag-Nerag
Gewerkschaft Gute Hoffnung Erdgas und Erdol GmbH
Gewerkschaft Kuchenberg Erdgas und Erdol GmbH
Goroku Sekiyu K.K.
Grande Ecaille Lan Company, Inc.
Groupement Immobilier Petrolier
Groupement Petrolier Aviation
Groupement Petrolier de la Cote D'Azur
Groupement Petrolier de Nantes
Groupement Petrolier du Finistere G.I.E.
Groupement pour l'Etude d'un Pipeline Bordeaux Toulouse
Hannoversche Erdolleitung G.m.b.H.
Hanshin Kyowa Sekiyu K.K.
Hayakawa Sekiyu K.K.
Heinrich Schneider Spedition GmbH
Hiroshima General Gas Juten Kabushiki Kaisha
Hoei Sekiyu K.K.
Hokushin Bussan K.K.
Hokuyu Sekiyu K.K.
Home Energy Company Ltd.
Home Oil Company Limited
Houston Regional Monitoring Corporation
Hydranten-Betriebscgesellschaft
Hydrierwerke Poelitz Aktiengesellschaft
Imperial Oil Limited
Imperial Pipe Line Company, Limited, The
Inada Ekka Gas Kabushiki Kaisha
Industry Promotion Enterprises Limited
Interprovincial Pipe Line (Alberta) Ltd.
Interprovincial Pipe Line Limited
Interprovincial Pipe Line (NW) Ltd.
Iranian Oil Participants Limited
Iranian Oil Services (Holdings) Limited
Iranian Oil Service Limited
Iraq Petroleum Company, Limited

Iraq Petroleum Pensions, Limited
Japan Butyl Company Limited
Japan Coal Liquefaction Development Company, Ltd.
Jersey Nuclear-Avco Isotopes, Inc.
K.K. Aizu General
K.K. Daimaru
K.K. General Sekiyu Hanbaisho
K.K. Genetech
K.K. Heian Sekiyu
K.K. Kanagawa Sekiyu Shokai
K.K. Kyoei Shosha
K.K. Kyowa Sekiyu Service
K.K. Marugo Izumasa Shoten
K.K. Nippatsu
K.K. Standard Sekiyu Osaka Hatsubaisho
K.K. Toresen
K.K. Uwano Sekiyu Shokai
K/S Statfjord Transport A/S & Co.
Kabushiki Kaisha Sankyo Plastics
Kai Tak Refuellers Company Limited
Kanto Kygnus Sekiyu Hambai K.K.
Karlsruhe-Stuttgart Rohrleitung Gesellschaft mbH
Kawasaki Kygnus Sekiyu Hambai Kabushiki Kaisha
Keiyo Sekiyu Hanbai K.K.
Kenya Petroleum Refineries Limited
Kibo Sekiyu Hanbai K.K.
Kimura Sekiyu Kabushiki Kaisha
Kinwa Sekiyu K.K.
Kobe Port Service Kabushiki Kaisha
Kobe Standard Sekiyu K.K.
Kowa Sekiyu K.K.
Kowloon Electricity Supply Company Limited
Kygnus Ekka Gas Kabushiki Kaisha
Kygnus Kosan Kabushiki Kaisha
Kygnus Marketing Service K.K.
Kygnus Sekiyu K.K.
Kyushu Eagle K.K.

LPL Investments, Inc.
Lakehead Pipe Line Company, Inc.
LEAG Aktiengesellschaft fur luzernisches Erdol
Leco Canada Inc.
Les Docks des Petroles d'Ambes
Long Beach Oil Development Company
Maasvlakte Olie Terminal N.V.
Maasvlakte Coal Terminal B.V.
Magota Sekiyu K.K.
Mainline Pipelines Limited
Maple Leaf Petroleum Limited
Maquinas de Coser y Bordar Sigma, S.A.
Marugo Gas K.K.
MEGAL FINCO
MEGAL GmbH
Meiji Sekiyu K.K.
MESBIC Financial Corporation of Houston
Metro Fuel Co. Ltd.
Mikawa Bussan K.K.
Minerals Limited
Mittelrheinische Erdgas Transport Gesellschaft mit beschrankter Haftung
Montreal Pipe Line Limited/Les Pipe-Lines Montreal Limitee
Mytex Polymers Incorporated
NAM—K 7 B.V.
NAM—K 14 B.V.
NAM—K 15 B.V.
NAM/CLOMS—K 8/K 11 B.V.
NAM/CLOMS—L 13 B.V.
N. V. Nederlandse Gasunie
NPC Services, Inc.
Nakabayashi Sekiyu K.K.
Nansei Oil Terminal K.K.
Nansei Sekiyu Kabushiki Kaisha
Native Venture Capital Co. Ltd.
Near East Development Corporation
Nederlandse Aardolie Maatschappij B.V.

Neptune Bulk Terminals (Canada) Ltd.
Nichimo Oil (Bermuda) Co., Ltd.
Nichimo Sekiyu Seisei Kabushiki Kaisha
Nikko Sangyo K.K.
Nippon Unicar K.K.
Nisku Products Pipe Line Company Limited
Nessei Sekiyu Kabushiki Kaisha
Norddeutsche Erdgas-Aufbereitungs G.m.b.H.
Norddeutsche Mineraloelwerke Stettin G.m.b.H.
Norddeutsche Oelleitungs-gesellschaft m.b.H.
Nordrheinische Erdgas Transport Gesellschaft mit beschrankter Haftung
Nord-West Oelleitung G.m.b.H.
Northward Developments Ltd.
Northwest Company, Limited
Nottingham Gas Limited
107580 Canada Inc.
139675 Canada Limited
151742 Canada Inc.
158585 Canada Limited
Office Prive d'Assurances et de Courtages
Offshore Medical Support Limited
Oil Field Chemicals Company (Saudi Arabia) Ltd.
Oil Service Company of Iran (Private Company)
Oil Spill Response Limited
Oil Transport Company (Saudi Arabia) Limited
Oldenburgishe Erdol Gesellschaft m.b.H.
Osaka Ashyu Nenryou K.K.
Osaka Propane Gas Hambai Kabushiki Kaisha
Osaka Sekiyu Gas Yuso K.K.
P.A.C. S.A.R.L. (Pinson Allegret-Causse)
P. T. Stanvac Indonesia
Pars Investment Corporation
Peninsula Electric Power Company Limited
Petroleum Refineries (Australia) Proprietary Limited
Petroleum Services (Middle East) Limited
Petrosvibri S.A.

Pinpoint Retail Systems Inc.
Pipe Line Services, Inc.
Plantation Pipe Line Company
Polder-Seehafen-Harburg GmbH
Portland Pipe Line Corporation
Primaer Oel GmbH
Progas A/S
Raffinerie du Midi S.A.R.L.
Rainbow Pipe Line Company, Ltd.
Redwater Water Disposal Company Limited
Refineria Petrolera Acajutla, S.A.
Renown Building Materials Limited
Rheingas Erdgasleitungs-Gesellschaft m.b.H.
Rochevert Inc.
Rotterdam Antwerpen Pijpleiding (belgie)
Rotterdam-Antwerpen Pijpleiding (Nederland) N.V.
Ruhrgas Aktiengesellschaft
S.A. du Pipeline a Produits Petroliers sur Territoire Genevois (SAPPRO)
S.A.R.L. Viain
SEAG Aktiengesellschaft fur schweizerisches Erdol
S.O.P.—Societa Oleodotti Padani S. p. A.
Saitama Sekiyu Hanbai K.K.
Sakurajima Futo K.K.
Sanko Oil Kabushiki Kaisha
Sanyo Sekiyu K.K.
Saraco S. A.
Saudi Arabian Lube Additives Company Limited
Schubert KG
Scurry-Rainbow Oil Limited
Seibu Kygnus Sekiyu Hambai Kabushiki Kaisha
Seismic Industries A/S
Senpoku Oil Service K.K.
SERAM Societa per Azioni
Servacar Ltd.
Shehtah Drilling Limited
Shimoka Sekiyu Kabushiki Kaisha
Shimoyama Sekiyu K.K.

Shin-Nihon Yukagaku Kogyo K.K.
Shinohara Oil K.K.
Shizuoka Kanesho Hambai Kabushiki Kaisha
Smiley Gas Conservation Limited
Sociedad Anonima "Escuela Campo Alegre"
Sociedad de Inversiones de Aviacion
Sociedad Nacional de Oleoductos Ltda.
Societa Italiana per l'Oleodotto Transalpino S.p.A.
Societa per Azioni Raffineria Padana Olii Minerali-SARPOM
Societe Anonyme de la Raffinerie des Antilles
Societe Anonyme des Hydrocarbures
Societe Anonyme "produits Lubrifiants de Madagascar"—PROLUMA S.A.
Societe Belge de Transport par Pipeline
Societe Civile de Mustapha Algerie
Societe Civile de Participation pour la Destruction des Dechets Industriels (SOCDI)
Societe Civile Immobiliere "Courcelles-Etoile"
Societe Civile Immobiliere de la Croix au Chene
Societe Civile Immobiliere du 195 Avenue de Neuilly
Societe Civile Immobiliere Khariessa
Societe Civile Immobiliere "Kleber-Etoile"
Societe Civile Immobiliere "Les Casseaux-Bougainville"
Societe de la Raffineria d'Alger
Societe de la Raffineria de Lorraine
Societe de Manutention de Carburants Aviation
Societe de Manutention de Carburants Aviation Dakar—Yoff, S.A.
Societe de Promotion et de Financement Touristique (CARTHAGO)
Societe d'Entreposage de San-Pedro
Societe des Pipe-Lines de Strasbourg
Societe des Transports Petroliers par Pipe Line
Societe d'Exploitation & de Developpement d'Operations Commerciales
Societe du Caoutchouc Butyl (SOCABU)

Societe de Pipe Line de la Raffinerie de Lorraine
Societe du Pipe-Line Mediterranee-Rhone
Societe du Pipeline Sud-European
Societe Esso de Recherches et d'Exploitation Petrolieres Esso Rep
Societe Francaise Exxon Chemical
Societe "Geomines-Caen"
Societe Havraise de Manutention de Produits Petroliers
Societe Hoteliera de la Petite Campagne
Societe Immobiliere Paris-Niel
Societe Ivoirienne d'Operations Petrolieres S.A.
Societe Malgache de Raffinage
Societe Reunionnaise d'Entreposage
Socony-Standard-Vacuum Oil Company (Petroleum Maatschappij)
Southern Natural Gas Development Pty. Ltd.
Standard Kosan Kabushiki Kaisha
Standard Service K.K.
Statfjord Transport A/S
Stockage Geologique de Gas de Lavera
Suddeutsche Erdgas Transport Gesellcshaft mit beschrankter Haftung
Sun East Company Ltd.
Supertex, Inc.
Sydis, Inc.
Syncrude Canada Ltd.
Synergistics Industries Limited
System Plaza Kabushiki Kaisha
TAR-Tankanlage Rumlang AG
TBN Tanklager-Betriebsgesellschaft Nurnberg MbH
Taglu Enterprises Ltd.
Taihei Bussan K.K.
Taiko Sekiyu K.K.
Taisei Kogyo Sekiyu Hanbai K.K.
Takahama Kosan Kabushiki Kaisha
Taketsuru Yugyuo K.K.

Tanaka Sekiyu Hanbai K.K.
Tankanlage A. G., Mellingen
Tanklager Altishausen A.G.
Tanklager Gesellschaft, Koln
Tanklager-Gesellschaft Tegel
Tanklager Lschelles I S.A.
Tanklager Taegerschen AG
Tecnica Quimica Petrolera, S.A. de C.V.
Tecumseh Gas Storage Limited
THUMS Long Beach Company
Thyssengas G.m.b.H.
TIBA Speditions GmbH
Toa Nenryo Kogyo Kabushiki Kaisha
Tohko Plastics Company, Limited
Tohpren Co. Ltd.
Toko Sekiyu K.K.
Tonen Energy International Corp.
Tonen Maintenance K.K.
Tonen Sekiyukagaku Kabushiki Kaisha
Tonen Tanker Kabushiki Kaisha
Tonen Technology K.K.
Towa Compounding Co. Ltd.
Towa Sekiyu K.K.
Toyoshina Film Company, Ltd.
Trans-Arabian Pipe Line Company
Transalpine Oelleitung in Oesterreich
Gesellschaft m.b.H.
Transgaz Lavera
Tsurumaru Unyu K.K.
Turkish Petroleum Company, Limited
UBAG—Unterflurbetankungsanlage Flughafen
Zurich
Van Salt Water Disposal Company
W.A.G. Pipeline Proprietary Limited
Wako Jushi Kabushiki Kaisha
Wako Kasei Kabushiki Kaisha
Wartempomp Nederland B.V.
Westdeutsche Erdolleitungs G.m.b.H.

Westgas G.m.b.H.
Westgastransport B.V.
Winnipeg Pipe Line Company Limited
Wohnungsbaugesellschaft, Steimbke-Rodewald G.m.b.H.
Worex et Cie
Yasaka Sekiyu K.K.
Yellowstone Pipe Line Company
Yoshiki Sekiyu Kabushiki Kaisha
Yoshimi Gas Kabushiki Kaisha
Yuai Sekiyu K.K.
Yugen Kaisha Nishi Kobe Bosai Center

KERR-MCGEE CORPORATION

The following are partially owned subsidiaries of Kerr-McGee Corporation:

Kerr-McGee Egypt, Ltd.
Kerr-McGee Limited
Kerr-McGee Oil (Australia) Pty. Ltd.
Kerr-McGee Oil (UK) PLC
Marine Resources Insurance, Limited
San-Ann Service, Inc.
Sunningdale Oils (Ireland) Limited
Sunningdale Oil (UK) Limited
Transnor Drilling Company Limited
Transocean Drilling Company Limited
Transocean Drilling Company (U.K.), Limited
Transocean Drilling (Curacao) N.V.
Transhore Drilling Company Limited
Transworld Drilling Company Limited
Transworld Drilling Company (Nigeria) Limited
Transworld Drilling UK Limited
Transworld North Sea Drilling Services Limited
Transworld Perfuracoes Maritimas Limitada
White Shoal Pipeline Corporation

The following are affiliates of Kerr-McGee Corporation:

Basic Management, Inc.
Bikita Minerals (Private) Limited
Downtown Airpark, Inc.
Texoma Pipeline Company
Walco Retail Services, Inc.

MARATHON OIL COMPANY

Marathon Oil Company is a wholly-owned subsidiary of USX Corporation. The subsidiaries of USX Corporation which are not wholly-owned are:

Athlone Prospecting & Development Corporation, Ltd.
First National Bank (Albion, PA)
Alfa Productos Matalurgicos, Ltda.
ITW Mapri (51% owned by Alfa Productos)
Companhia Siderurgica Paulista "Cosipa"
Merinda Mineracaco (Partnership)
Mineracao Buritirama Ltda.
Mineracao Carajas, Ltda. (Partnership)
Mineracao Maraba, Ltda. (Partnership)
Mineracao Xingu, Ltda. (Partnership)
Termerid Mineracao, SA
Torremco Soc. Min. E Com. Ltda. (Partner)
Deepsea Ventures, Inc.
Ocean Mining Associates—Joint Venture
USS-POSCO Industries—Partnership
Sidbec-Normines, Inc.
U.S. Steel France
Compaignie Miniere de l'Ogoous (Comilog)
Feralloys, Ltd.
Zeerust Chrome Mines, Limited
USS Technology (Japan) Ltd.
ACE Holdings, Inc.
Coda Holding, Ltd. (CODA-H)
Corporate Officers & Directors Assurance, Ltd. (CODA)

Adala Investment Company, S.A.
Altos Hornos de Vizcaya, S.A. (AHV)
Associated Manganese Mines of South Africa, Ltd.
Associated Ore & Metal Corporation, Ltd.
Avsteel SWA, Ltd.
Blue Grass Phosphate Company
Chrome Deposit Corp. (Court Holdings J.V.)
Kappa Mining & Prospecting Co., Ltd.
La Pointe Iron Company
Navios Shipping Corp.
Oresteel Investments (Proprietary), Ltd.
Priaska Copper Mines (Pty.) Ltd.
Sigma Mining & Prospecting Co. (Pty.) Ltd.
Societe Des Mines De Fer De Guines Pour L'Exploitation Des Monts Nimba (Mifergui Nimba)
Tilden Iron Mining Company
West Union Canal Company, The
Zuari Agro Chemicals Ltd.
Advanced Environmental Systems-Partnership
Bartow Chemical Products
Century III Associates
Fort Meade Chemical Products
Double Eagle Steel Coating Co.–Joint Venture
Live Oak Uranium Operations
National Oilwell-Partnership
Rockland Joint Venture (Cost-Sharing)
RMI Company
Tenn-USS Chemicals Co.—Joint Venture
Worthington Specialty Processing

The following companies are subsidiaries or affiliates of Marathon Oil Company, a wholly-owned subsidiary of USX Corporation:

Arctic LNG Transportation Company
Badger Pipe Line Company
CLAM Petroleum Company
Cook Inlet Pipe Line Company

Explorer Pipeline Company
Gravcap, Inc.
Green Bay Terminal Corporation
Kenai LNG Corporation
LOCAP, Inc.
LOOP Inc.
Oasis Oil Company of Libya, Inc.
Oil Insurance Limited
Petroleum Terminals, Incorporated
Pilot Oil Corporation
Platte Pipe Line Company
Polar LNG Shipping Corporation
Russell Stewart Oil Co.
West Shore Pipe Line Company
Wolverine Pipe Line Company

The following companies are subsidiaries or affiliates of TXD Corporation, a wholly-owned subsidiary of USX Corporation:

Acadian Gas Pipeline System
Bayou Interstate Pipeline System
Calcasieu Gas Gathering System
Louisiana Industrial Gas Supply System
Neches Pipeline System
Pelican Interstate Gas System
Pelican Transmission System
Pontchartrain Natural Gas System
Spindletop Gas Distribution System
Alabama Intrastate Supply
Red River Pipeline
Red River Pipeline Corporation
Ozark Finance Corporation
Ozark Gas Transmission System

MAXUS ENERGY CORPORATION
DIAMOND SHAMROCK OFFSHORE PARTNERS LIMITED PARTNERSHIP

Maxus Energy Corporation is the special general partner of Diamond Shamrock Offshore Partners Limited Partnership. Diamond Shamrock is not totally owned by Maxus Energy Corporation. There are no other subsidiaries or affiliates whose stock or debt securities are traded in the United States or Canada.

MITCHELL ENERGY CORPORATION

Mitchell Energy Corporation is a wholly-owned subsidiary of Mitchell Energy & Development Corp. Mitchell Energy Corporation has no subsidiaries or affiliates with stock or debt securities publicly traded in the United States or Canada.

MOBIL OIL CORPORATION
MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST INC.
MOBIL PRODUCING TEXAS & NEW MEXICO INC.
and
MOBIL EXPLORATION AND PRODUCING NORTH AMERICA INC.

Mobil Oil Corporation and Mobil Exploration and Producing North America Inc. are wholly-owned subsidiaries of Mobil Corporation. Mobil Oil Exploration & Producing Southeast Inc. and Mobil Producing Texas & New Mexico Inc. are wholly-owned subsidiaries of Mobil Oil Corporation. The subsidiaries and affiliates of Mobil Oil Corporation or Mobil Corporation whose securities are available for purchase by United States citizens in the United States are:

Marcor Inc.
Mobil Alaska Pipeline Company
Montgomery Ward & Co., Incorporated
Montgomery Ward Credit Corporation

PHILLIPS PETROLEUM COMPANY
PHILLIPS 66 NATURAL GAS COMPANY

Non-wholly-owned subsidiaries and affiliates:

Alyeska Pipeline Service Company
Arctic LNG Transportation Company
Bissendorf Biosciences GmbH
Canada Western Cordage Company, Limited
Canyon Reef Carriers, Inc.
Chisholm Pipeline Company
Cochin Refineries Limited
Colonial Pipeline Company
Dixie Pipeline Company
East Texas Salt Water Disposal Company
Explorer Pipeline Company
Great Yarmouth Port Labour Company Limited
Heat Transfer Research, Inc.
Insurance & Reinsurance Brokers (Bermuda) Limited
Iranian Marine International Oil Company—Iminoco
Kenai LNG Corporation
Long Beach Oil Development Company
Multinational Gas & Petrochemical Company
Multinational Gas and Petrochemical Services Limited
Norland GmbH Fur Grundbesitz Und Industrienlagen
Norpipe A.S.
Norpipe Petroleum UK Limited
Norsea Gas A/S
Norsea Gas GmbH

Norsea Pipeline Limited
Oil Insurance Limited (New)
Papago Chemicals, Inc.
Phillips Carbon Black Limited
Phillips Petroleos Chile S.A.
Phillips Petroleum Singapore Chemicals (Private) Limited
Phillips Petroleum Toray Inc.
Phillips-Imperial Petroleum Limited
Polar LNG Shipping Corporation
Proteina Brasileira Ltda.
Renoilt—Haus GmbH
Solar Gas, Inc.
Spodco Limited
Spodco-USA, Inc.
The Salk Institute Biotechnology/Industrial Assoc. Inc.
Venezoil, C.A.
Western Desert Operating Petroleum Company (WEPCO)
White River Shale Oil Corporation

PLACID OIL COMPANY

Placid Oil Company is a privately owned corporation. It has no subsidiaries or affiliates which are not wholly-owned.

ROSEWOOD RESOURCES, INC.

Rosewood Resources, Inc., a Delaware corporation, is a wholly owned subsidiary of The Rosewood Corporation, a Texas corporation. The Rosewood Corporation is a privately held corporation, all of the stock of which is owned by the Caroline Hunt Trust Estate.

SHELL OFFSHORE INC.
SHELL WESTERN E&P INC.

Shell Oil Company wholly owns all of the stock of Shell Energy Resources, Inc., which company wholly-owns all of the stock of Pecten International Company, Scallop Coal Corporation, Shell Offshore, Inc., Shell Mining Company and Shell Western E&P Inc. All of Shell Oil Company's common stock is owned by SPNV Holdings, Inc., a Delaware corporation, whose stock is owned by Shell Petroleum N.V., a Netherlands company. The voting shares of Shell Petroleum N.V. are held sixty percent (60%) by Royal Dutch Petroleum Company and forty percent (40%) by Shell Transport and Trading Company, a Public Limited Company in London, U.K. Shell Oil Company also wholly-owns directly or indirectly a number of companies. The following companies are affiliates of the companies named above, but are not wholly-owned subsidiaries:

Fractionation Research, Inc.
Gravcap, Inc.
Heat Transfer Research, Inc.
Inland Corporation
Loop, Inc.
MESBIC Financial Corporation of Houston
Oil Companies Institute for Marine Pollution Compensation Limited
Oil Insurance Limited
Seadock, Inc.
Pecten Cameroon Company
Thums Long Beach Company
East Texas Salt Water Disposal Company
Grande Ecallie Land Company, Inc.
Van Salt Water Disposal Company
Wyoming Industrial Development Corporation
Lucky Chance Mining Company, Inc.
George Neuman and Company
United Scientific, Inc.

SUN EXPLORATION AND PETROLEUM COMPANY, INC.

Sun Exploration and Production Company, Inc. is a wholly-owned subsidiary of Sun Company, Inc. The affiliates and subsidiaries, not wholly-owned, of Sun Company, Inc., are:

Llaves-Gavilan Company
Radep Pipeline Company
Sun Cogeneration Company
Sun Crude Marketing & Transportation, Inc.
Sun Gas Transmission Company, Inc.
Sun Offshore Gathering Company
Canyon Reef Carriers, Inc.
East Texas Salt Water Disposal Company
Mesbic Financial Corporation of Dallas
Van Salt Water Disposal Company
Castle Valley Company
Sun Energy Partners, L.P.
Radep Pipeline Limited Partnership
Sun Cogeneration Limited Partnership
Sun Crude Marketing & Transportation Limited Partnership
Sun Gas Transmission Limited Partnership
Sun Offshore Gathering Limited Partnership
Sun Operating Limited Partnership
Sun Pennsylvania Limited Partnership
Sun Gas Liquids, Inc.
Sun Exploration and Production Company of Pennsylvania, Inc.
Sun Gas Terminals and Storage (PA.), Inc.
Sun Equity, Inc.
Sun Texas Company
British Sun Oil Company Limited
Dubai Sun Oil Company
Iranian Sun Oil Company
Lavan Petroleum Company (LAPCO)

Libyan Sun Oil Company
North Sea Sun Oil Company Ltd.
Sol de Colombia Oil Company
Sun Angola Oil Company
Sun Australian Oil Company, Inc.
Sun Bolivian Oil Company
Sun Borneo Oil Company, Inc.
Sun Colombia Oil Company
Sun Deutsche Oil Company
Sun Eastern Exploration Company
Sun Egypt Oil Company
Sun Europe Oil Company
Sun Europe Oil Company et Compagnie
Sun French Oil Company
Sun Gabon Oil Company
Sun Hispanic Oil Company
Sun Indonesia Oil Company
Sun Irish Oil Company
Sun Italy Oil Company
Sun Malaysia Oil Company
Sun Noordzee Oil Company
Sun Norsk Oil Company
Scandinavian Sun Oil Company A/S
Sun Oil Algerie Inc.
Sun Oil Company North Africa, Ltd.
Sun Oil Company (U.K.) Ltd.
Sun Oil International, Inc.
Liberian International American
Sun Orient Exploration Company
Sun Overseas Petroleum, Inc.
Sun Philippine Oil Company
Sun Sudan Oil Company, Inc.
Sun Support Services, Inc.
Sun Support Venezuela, Inc.
Sun Thailand Oil Company
Sun Vietnam Oil Company
Sun Worldwide Services, Inc.
Sunray Iranian Oil Company, Inc.
Sunray Nigeria, Inc.

Sunray Nigeria Oil Company Unlimited
Sunray Venezuela Oil Company, Inc.
Venezoil C.A.
Venezuelan Sun Oil Company

TEXACO, INC.

The affiliates and subsidiaries of Texaco Inc. listed on its most recent Form 10-K filed with the Securities and Exchange Commission are as follows:

Getty Oil Company
Texaco Pipeline Inc.
Riverway Gas Pipeline Company
Texaco Producing Inc.
Texaco Refining and Marketing Inc.
Texaco Trading and Transportation Inc.
Deutsche Texaco AG
Norsk Texaco Oil A/S
S. A. Texaco Belgium N.V.
S. A. Texaco Petroleum N.V.
Texaco A/S
Texaco Britain Limited
Texaco Denmark Inc.
Texaco Investments (Netherlands), Inc.
Texaco (Ireland) Limited
Texaco Limited
Texaco North Sea U.K. Company
Texaco Oil Aktiebolag
Texaco Petroleum Maatschappij (Nederland) B.V.
Refineria Panama S.A.
Refineria Texaco de Honduras, S.A.
Texaco Brasil S.A.-Productos de Petroleo
Texaco Caribbean Inc.
Texaco Nigeria Limited
Texaco Panama Inc.
Texaco Petroleum Company
Texaco Trinidad, Inc.
Texas Petroleum Company

Texaco Butadiene Company
Texaco Chemical Company
Texaco Canada Inc.
Texaco Canada Resources Ltd.
Texaco Canada Resources
Getty Marine Corporation
Texaco International Trader Inc.
Texaco Overseas Holdings Inc.
Texaco Overseas Petroleum Company
Texaco Overseas Tankship Ltd.

UNION OIL COMPANY OF CALIFORNIA

The non-wholly-owned affiliate of Union Oil Company of California is Union Exploration Partners, Ltd.

UNION PACIFIC RESOURCES COMPANY

The parent of Union Pacific Resources Company is Union Pacific Corporation. The non-wholly-owned subsidiaries and affiliates of Union Pacific Corporation are:

Bear Creek Uranium Company
Black Butte Coal Company
Camas Prairie Railroad Company
Carbon County Coal Company
Corpus Christi Petrochemical Company
The Denver Union Terminal Railway Company
Esperanza Pipeline Company
Ferguson-Burleson County Gas Gathering System
Frontier Pipeline
Jefferson Southwestern Railroad Company
Kansas City Terminal Railway Company
Longview Switching Company
M-C Carbon Partnership
Medicine Bow Coal Company
The Ogden Union Railway and Depot Company
Portland Traction Company
Portland Terminal Railroad Company
The St. Joseph and Grand Island Railway Company

St. Joseph Terminal Railroad Company
Southern Illinois and Missouri Bridge Company
Stansbury Coal Company
Stauffer Chemical Company of Wyoming
Trailer Train Company
Uinta Development Company
Union Pacific Corporation
Union Pacific Resources Ltd.
Upland Industries Corporation
The Weatherford Mineral Wells and Northwestern Railroad Company
Arkansas & Memphis Railway Bridge and Terminal Company
Automated Monitoring and Control International, Inc.
Central California Traction Company
Chicago and Western Indiana Railroad Company
Great Southwest Railroad, Inc.
Oakland Terminal Railway
Railroad Association Insurance Limited
Terminal Railroad Association of St. Louis
Texas City Terminal Railway Company
The Belt Railway Company of Chicago
The Pueblo Union Depot and Railroad Company
Union Pacific Realty Company

UNION TEXAS PETROLEUM CORPORATION

Union Texas Petroleum Corporation is a wholly-owned subsidiary of Union Texas Petroleum Holdings, Inc. The affiliates of Union Texas Petroleum Corporation, not wholly-owned, are:

Benoil, Inc.
Union Petrolera Venezolana C.A.
Union Texas Abu Dhabi (Offshore), Inc.
Union Texas Abu Dhabi (Onshore), Inc.
Union Texas Asia Corporation
Union Texas Brasil, Inc.

Union Texas Egypt, Inc.
Union Texas Guinea, Inc.
Union Texas Insurance, Ltd.
Union Texas Oman, Inc.
Union Texas Peru, Inc.
Union Texas Petrolera de Guatemala, Inc.
Union Texas Petroleum First Financial Corporation
Union Texas Petroleum 601, Inc.
601 Operating Company, Inc.
Union Texas Petroleum Corporation
Union Texas Petroleum Europe & Middle East, Inc.
Union Texas Portugal, Inc. S.A.R.L.
Union Texas Products Corporation
Union Texas (South East Asia), Inc.
Union Texas Tunisia, Inc.
Unisea Corporation
Unistar, Inc.
UT Colombia, Inc.

The subsidiaries of Union Texas Petroleum Corporation are:

Chico Corporation
Chico of Texas Corporation
Union Texas Canada, Ltd.
Union Texas Exploration Corporation
Lake City Mines, Inc.
Supron Energy (U.K.), Ltd.
Supron Minerals Company
Supron Overseas, Inc.
Unicon Producing Company
Union Texas International Corporation
Union Texas Brunei Limited
Union Texas East Kalimantan Limited
Union Texas Espana, Inc.
Union Texas Indonesia, Ltd.
Union Texas Pakistan, Inc.
Union Texas Petroleum Limited
UTPL Overseas Limited

Unola de Argentina, Ltd.
Union Texas Offshore, Inc.
Union Texas Pipeline Corporation

The subsidiaries and affiliates of Union Texas Products Corporation are:

Fuelane Corporation
Rising Star Pipeline Corporation
Union Texas Trading Corporation
Union Texas Italia, Inc.

The subsidiaries and affiliates of Unistar Inc. are:

Unimar Company
Enstar Corporation
Enstar Insurance, Ltd.
VICO 7.5, Inc.
Virginia Indonesia Co.
Enstar Indonesia, Inc.
Virginia International Company
Vico Trading, Inc.
Alaska Interstate Int'l Finance, N.V.
Alaska Interstate Int'l Finance, B.V.
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(3)

No. 87-978

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF IN OPPOSITION FOR RESPONDENTS ASSOCIATED GAS DISTRIBUTORS, AMERICAN PUBLIC GAS ASSOCIATION, PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, NEW YORK PUBLIC SERVICE COMMISSION, AND UNITED DISTRIBUTION COMPANIES

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-978

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF IN OPPOSITION FOR RESPONDENTS ASSOCIATED GAS DISTRIBUTORS, AMERICAN PUBLIC GAS ASSOCIATION, PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, NEW YORK PUBLIC SERVICE COMMISSION, AND UNITED DISTRIBUTION COMPANIES

Associated Gas Distributors (AGD),[1] American Public Gas Association (APGA),[2] th Public Utilities Commis-

[1] AGD is an informal association of some 40 local gas distribution utilities. Pursuant to Sup. Ct. R. 28.1, a list of AGD member companies and their affiliates is attached as Appendix A hereto.

[2] APGA is an informal, not-for-profit association which was formed to further the interests of publicly-owned natural gas dis-

sion of the State of California, the New York Public Service Commission, and the United Distribution Companies (UDC),[3] petitioners and intervenors in the proceeding below, hereby respond in opposition to the petition of Shell Offshore Inc., *et al.* for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit.[4]

STATEMENT OF THE CASE

Petitioners seek review of the portion of the opinion of the lower court in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (*AGD v. FERC*) (Pet. App. at 1a-128a) [5] reversing and remanding Order No. 436 for its failure to explain adequately its inaction on the industry-wide take-or-pay problem.[6] In Order No.

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tribution systems. APGA currently has over 225 member systems located in 33 states. Although counsel does not believe that a list of APGA's member systems is required by Sup. Ct. R. 28.1, such a list is attached hereto for the Court's convenience as Appendix B.

[3] UDC is an *ad hoc* group of 32 organizations which provide gas utility service to the general public. Pursuant to Sup. Ct. R. 28.1, a list of UDC member companies and their affiliates is attached as Appendix C hereto.

[4] The petition for a writ of certiorari filed by Shell Offshore Inc., *et al.* in No. 87-978 is one of a number of petitions pending in this Court seeking review of the decision in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987). The parties to this brief take no position on whether a writ of certiorari is warranted for review of the questions presented in any of the other petitions, but reserve their rights, jointly and severally, to brief those questions should certiorari be granted.

[5] "Pet. App." references are to the Appendices to Petition for Writ of Certiorari of Shell Offshore Inc., *et al.* in No. 87-978.

[6] The Commission's orders below consisted of a Final Rule, one modification to the Final Rule and a number of orders denying rehearing or reconsideration. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, Final Rule and Statement of Policy, 50 Fed. Reg. 42,408 (1985); Order No. 436-A,

436, the Federal Energy Regulatory Commission ("Commission" or "FERC") undertook a major rulemaking proceeding which "envisages a complete restructuring of the natural gas industry" (Pet. App. at 17a). The court's opinion upheld the major provisions of the Commission's action, but remanded the case to the Commission for further consideration of several "interdependent" (Pet. App. at 124a) aspects of the Commission order. Petitioners in No. 87-978 seek this Court's review of the court of appeals' directive that the Commission reconsider its determination to take no affirmative action in Order No. 436 with respect to the major take-or-pay problem facing the interstate pipelines, despite the substantial adverse impact of Order No. 436 upon the take-or-pay situation.

The primary objective of FERC Order No. 436 was to open up the natural gas industry to competition through enhanced transportation of gas supplies by interstate pipelines. Previously, gas was generally purchased from producers by the pipelines under long-term contracts and resold to local distributors for ultimate disposition. The objective of increased competition was achieved by the Commission in Order No. 436 by "unbundling" the pipeline's merchant and transportation roles. Any pipeline seeking to secure blanket certificates for the transportation of gas, which are a competitive necessity in most instances, would be required to provide open, non-discriminatory transportation on a "first-come,

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Final Rule; Order Granting in Part and Denying in Part Applications for Rehearing, Denying Petition for Stay, and Granting Clarification, 50 Fed. Reg. 52,217 (1985); Order No. 436-B, Order Granting in Part Petitions for Rehearing and Reconsideration, 51 Fed. Reg. 6398 (1986); Order No. 436-C, Order Denying Rehearing, 51 Fed. Reg. 11,566 (1986); Order No. 436-D, Order Denying Applications for Rehearing, 51 Fed. Reg. 11,569 (1986); Order No. 436-E, Order Denying Request for Reconsideration, 51 Fed. Reg. 11,566 (1986). For ease of reference, the Order No. 436 series will be referred to herein as "Order No. 436."

first-served" basis pursuant to rate standards established by the Commission. Order No. 436 also furthered the goal of enhanced competition by authorizing the pipelines' existing firm sales customers to reduce or convert to firm transportation all of their contract demand obligations to purchase pipeline gas over a period of five years.

The parties to this brief, as well as most of the other local distribution companies and state commissions filing comments in the Commission's rulemaking proceeding, noted in their comments that the shift by pipelines' customers from sales to transportation service made possible by the Commission's proposed rulemaking would compound the already serious problem resulting from the multi-billion dollar pipeline take-or-pay obligations under existing long-term, high-priced contracts. These parties urged the Commission to take affirmative action to relieve the pervasive take-or-pay problem. Primary among the suggested avenues for such relief were that the Commission (1) condition a pipeline's obligation to transport a producer's gas sold directly to a distributor or end-user upon the producer's reformation of its problem contracts, and (2) exercise its authority under Section 5 of the Natural Gas Act, 15 U.S.C. §§ 717 *et seq.* (1982) (NGA) to prescribe the just and reasonable terms for contracts it found to have become unjust, unreasonable, unduly discriminatory, or preferential. *See* 15 U.S.C. § 717d.

The Commission in Order No. 436 refused to follow either of those paths for take-or-pay relief. Pet. App. at 78a-79a. Nor did it take any other affirmative action. *Id.* Instead, it limited itself to urging the producers and pipelines to reform their problem contracts, and to reassuring the producers that any buy-out or buy-down payments the pipelines might make in settlement of accrued take-or-pay obligations, or to reform problem contracts, would not be construed by the Commission to vio-

late the ceiling rates prescribed by the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301 *et seq.* (1982) (NGPA). Pet. App. at 76a-77a.

Judicial review of Order No. 436 was sought by members of "[v]irtually every sector of the natural gas industry," and the Commission's rulemaking was challenged on "a dazzling array of errors and omissions." Pet. App. at 18a. The court of appeals in *AGD v. FERC* "[upheld] the substance of Order No. 436 and the procedures the Commission employed in adopting it" (Pet. App. at 123a), but concluded that FERC's decision to take no affirmative action on the take-or-pay problem, which it found had been "dramatically increase[d]" by the Commission's actions in Order No. 436 (Pet. App. at 83a), "reflects questionable legal premises and fails to meet the requirement of 'reasoned decisionmaking.'" Pet. App. at 80a. Accordingly, it remanded the matter to the Commission "to determine, in light of our discussion of its questionable factual and legal premises, to what extent these policy considerations may justify its inaction on the uneconomical producer-pipeline contracts." Pet. App. at 94a. Judge Mikva joined in the court's conclusion that the Commission's explanation for its refusal to act on the take-or-pay problem was inadequate, but dissented from the majority's suggestion that the Commission on remand might again refrain from any positive action. Pet. App. at 126a.

On August 7, 1987, the Commission issued Order No. 500 [7] which was designed "to respond to the Court's con-

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[7] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500, Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (1987), 52 Fed. Reg. 35,539 (1987); Order No. 500-A, Interim Rule; Order Granting Extension of Time for Responses to Take-or-Pay Data Request, 52 Fed. Reg. 39,507 (1987); Order No. 500-B, Order Denying Rehearing in Part, Granting Rehearing in Part, and Modifying Prior Order, 52 Fed. Reg. 39,630 (1987); Order No. 500-C, Order on Rehearing Modifying Prior

cerns about Order No. 436 on an interim basis . . . ." 52 Fed. Reg. 30,335 (1987).[8] With respect to the take-or-pay issue, Order No. 500 adopted a limited process under which pipelines would not be required to transport gas sold directly by producers to local distribution companies or end-users unless the producers agreed to credit the pipeline's take-or-pay obligations accrued since Order No. 436 became effective. This action is the subject of a number of petitions for review in various courts of appeals, including petitions by most of the petitioners in No. 87-978.[9] The rule was issued on an interim basis pending "a more thorough examination of the issues [identified by the court] before developing a final rule." 52 Fed. Reg. 30,335 (1987). By Order of September 15, 1987, the Court of Appeals for the District of Columbia Circuit permitted Order No. 500 to be immediately effective, and the Commission's open-access transportation rules—which represent the crux of Order No. 436—are thus fully in effect.

REASONS FOR DENYING THE PETITION

1. None of the circumstances identified by this Court as warranting the granting of a writ of certiorari is present here. This Court has expressed the view that review of Commission orders is "primarily the task of the court of appeals," *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 309 (1974), and that the Supreme Court's " 'authority is essentially narrow and circumscribed.' " *Id.*, quot-

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Orders and Requesting Comments, 52 Fed. Reg. 48,986 (1987); Order No. 500-D, Order Modifying Dates (issued March 8, 1988), —— Fed. Reg. —— (1988).

[8] Significantly, the Commission did not seek rehearing of the court's decision, nor has it petitioned this Court for a writ of certiorari.

[9] The parties to this brief believe that the Commission's response to the court of appeals' mandate thus far is completely inadequate, and are also pursuing judicial challenges below.

ing *Permian Basin Area Rate Cases*, 390 U.S. 747, 766 (1968). Where Congress has placed responsibility for review "'in the keeping of the Courts of Appeals,'" "'[t]his Court will intervene only . . . when the standard appears to have been misapprehended or grossly misapplied.'" *Mobil Oil Corp., supra*, 417 U.S. at 310, quoting *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 491 (1951).

As is shown below, the court of appeals did not "misapprehend" or "grossly misapply" the standard of judicial review. *See Mobil Oil Corp., supra.* Indeed, the court was fully aware and respectful of the Commission's primary responsibility with respect to the matters addressed in the orders under review, and judged the Commission's determinations by applying factual findings and policy judgments made by FERC itself. Under the circumstances, the issues presented here do not meet the guidelines established by this Court for the granting of a writ of certiorari, and the petition should therefore be denied.

2. Petitioners cite three reasons why this Court should grant the petition. None of petitioners' purported reasons can support the granting of the writ because, as a threshold matter, the court did none of the things that petitioners find objectionable. Petitioners argue that:

(a) the court of appeals "disregarded" statutory limitations on the Commission's authority to take action to affect uneconomic contracts;

(b) the court of appeals engaged in its own economic analyses and factual findings;

(c) the court of appeals deprived the Commission of its discretion to select the proceeding in which it will address the take-or-pay issue.

Each of these contentions is based on an erroneous reading of the *AGD v. FERC* opinion and should be rejected as a basis for review by this Court.

a. The thrust of petitioners' first argument appears to be that the court of appeals effectively required the Commission to take some specific action which petitioners assert is beyond the Commission's power. *See* Petition at 9, 13, 17.[10] Petitioners admit that the court's remand ordered the Commission to provide a more detailed rationale for its failure to deal with the take-or-pay crisis (Petition at 9, 17), but suggest that the granting of the writ is warranted because "[t]he court of appeals' mandate has been widely interpreted as a requirement for Commission action." Petition at 9. Petitioners' challenge amounts to a premature and collateral attack on Order No. 500. Indeed, petitioners virtually acknowledge that it is Order No. 500—*i.e.*, FERC's response to the court's opinion, not the court's opinion itself—that contains the elements they seek to challenge here:

> In rejecting the Commission's analysis of take-or-pay issues, the court of appeals stated that the Commission should consider conditioning producer access to pipeline transportation on producer willingness to modify the so-called "problem contracts." In response, the Commission immediately imposed such a condition on transportation access.

Petition at 9 (footnotes omitted).

The parties to this brief strongly disagree with petitioners' legal objections to the imposition of any remedy under Sections 5 or 7 of the Natural Gas Act, 15 U.S.C.

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[10] Significantly, petitioners have argued to the contrary before the Commission. The Joint Comments of Indicated Producers (which included 25 of the same companies that are petitioners here (see Appendix D at 15a-20a)) on FERC Order No. 500, Docket No. RM87-34-000 (filed October 13, 1987), argued that the court opinion "merely indicated that the Commission had not provided sufficient explanation why a conditioned access scheme would be unduly discriminatory" (Appendix D at 21a), and that the court "did not direct the Commission to invoke Section 5. Rather, it directed the Commission only to 'reassess' its decision not to do so." Appendix D at 22a.

§§ 717d, 717f. But, even if petitioners' legal arguments were persuasive, they would not present questions warranting review by this Court in the present posture of the proceedings. Since the court of appeals neither affirmed Commission action adversely affecting petitioners nor mandated such action, any consideration by this Court of the legal questions which might be presented by the Commission's actions on remand [11] would necessarily be in the nature of an advisory opinion on issues that are not ripe for review and which may never be involved in a case or controversy before this Court. That is not the function of this Court. As recognized by petitioners themselves (at 16-17 in their Brief in Opposition to petitions filed in Nos. 87-976, 87-977, and 87-1091), any such advisory opinion is precluded by *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967).

b. Similarly, there is no basis for petitioners' contention that the court of appeals encroached upon Commission authority by substituting its own findings of fact and engaging in its own economic analyses. The three examples cited in support of this proposition in no way demonstrate a lack of judicial deference to agency determinations; rather, they present situations in which the court of appeals, in the proper exercise of its review function, found that the Commission had failed to consider adequately the available options, or that there was a fundamental inconsistency between the Commission's factual findings and ultimate conclusions.

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[11] The Commission's action on remand in Order No. 500 is presently the subject of review proceedings, too numerous to list and as yet unconsolidated, including actions brought by most of the petitioners in No. 87-978, raising many of the legal issues petitioners seek to have this Court consider in their present petition. No opinions have been issued in these proceedings. The Commission, to date, has taken no action on remand under Section 5 of the Natural Gas Act.

Thus, contrary to petitioners' claim, the Commission itself found that "the bulk of high-cost 'problem' contracts" was for regulated Section 102(d) gas, and therefore indisputably subject to its jurisdiction. *See* 50 Fed. Reg. 52,226 (1985). The court recognized that the Commission had made such a finding, and on that basis rejected FERC's assertion that a Section 5 remedy would be inefficient and inequitable. Pet. App. at 89a. Rather than reaching its own conclusions, the court simply noted an irreconcilable conflict between the Commission's own factual findings and the conclusions it reached therefrom.

Similarly, the court did not dispute the Commission's ability to consider policy objections to government intervention in private contracts in determining whether to order affirmative take-or-pay relief, but found that FERC had failed to consider countervailing policy considerations in light of current market realities and the applicable statutory framework. Pet. App. at 89a-90a.

Finally, the court concluded that the Commission's assumption that producers would voluntarily reform contracts which required the pipelines to pay for high cost gas not taken, and therefore that there was no need for Commission intervention, simply "assumes away the problem of the uneconomical contracts to which pipelines are presently bound" and "confuse[s] the pipelines' *incentive* to renegotiate contracts with their *ability* to do so." Pet. App. at 83a (emphasis in original). But, contrary to petitioners' suggestion, the court of appeals did not direct the Commission to take affirmative action if, on reconsideration, it could support its original position by a rational explanation, founded on a substantial factual predicate.

c. There is no merit to petitioners' argument that the court usurped the Commission's authority by requiring it to consider the problem of unlawful producer contracts in a particular proceeding. Petition at 21-23. The court did not in any way deprive the Commission of its discretion to choose the proceeding in which it will deal with

particular issues;[12] it was the *Commission itself* that chose to consider the problem of uneconomic contracts in this rulemaking. The take-or-pay problem received prominent attention in Order No. 436, and the Commission itself recognized that "current and future take-or-pay obligations could possibly impede development of a more competitive gas market." 50 Fed. Reg. 42,464 (1985). The Commission did not seek to defer the take-or-pay issue to other proceedings; instead, it addressed it in Order No. 436 and reached the conclusion that no further action by it was necessary or appropriate.

In this context, having found that the Commission's rationale for its inaction was legally and factually unsupported, the court of appeals acted within the proper bounds of its authority in directing the Commission to reassess its refusal to act. The crux of Order No. 436—the "unbundling" of the pipelines' transportation and merchant roles—necessitated some contemporaneous treatment of take-or-pay. Order No. 436 had the express purpose of allowing customers to use pipelines for transportation services as an alternative to the pipelines' traditional (merchant) sales services, thereby threatening pipelines with reduced sales volumes and an increased take-or-pay burden. The court recognized these possibilities and found that

> FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability, and its tendency to elevate into affirmative benefits what are at best palliatives, seem impossible to square with the requirement of reasoned decisionmaking.

Pet. App. at 84a. Thus, as both the Commission and the court of appeals recognized, the objectives of Order No. 436 and their inextricable impact upon pipeline take-or-

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[12] Significantly, the court's opinion contains a number of instances in which it deferred to the Commission's judgment to consider specific issues at another time or place. *See, e.g.*, Pet. App. at 45a-46a; 113a.

pay obligations compelled resolution of the problems caused by uneconomic producer contracts in the present rulemaking.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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March 16, 1988

APPENDICES

APPENDIX A

ASSOCIATED GAS DISTRIBUTORS

Atlanta Gas Light Company

Subsidiaries:

Georgia Gas Company
Georgia Engine Sales & Service
Trustees Investments, Inc.
Georgia Natural Gas Company
Georgia Gas Service Company
Georgia Energy Company

Baltimore Gas & Electric Company

Susidiaries:

BNG, Inc.
Constellation Holdings, Inc.
Constellation Investments, Inc.
Constellation Properties, Inc.

Affiliate:

Safe Harbor Water Power Corporation

Bay State Gas Company

Subsidiaries:

Bay State Exploration, Inc.
Bay State Gas Supply, Inc.
Northern Utilities, Inc.
Granite State Gas Transmission, Inc.

The Berkshire Gas Company

Boston Gas Company

Parent: Eastern Gas and Fuel Associates

The Brooklyn Union Gas Company

Subsidiaries:

Fuel Resources, Inc.
Fuel Resources Gathering, Inc.
Brooklyn Union Exploration Company, Inc.
Gas Energy, Inc.
Methane Development Corporation
Collectaccount Services, Inc.
Star Enterprises, Inc.
Delaware Valley Propane Company

Central Hudson Gas & Electric Corporation

Subsidiaries:

Central Hudson Enterprises Corp.
Central Hudson Cogeneration, Inc.
CH Resources, Inc.
Greene Point Development Corp.
Phoenix Development Co., Inc.

Chesapeake Utilities Corporation

Subsidiaries:

Central Florida Gas Co.
Eastern Shore Natural Gas Co.
Dover Exploration Co.
Skipjack, Inc.
Sharpgas, Inc.

City of Holyoke, Mass., Gas & Electric Department

City of Norwich, Department of Public Utilities

City of Westfield Gas & Electric Light Department

Colonial Gas Company

Subsidiary:

Transgas, Inc.

Commonwealth Gas Co.

Parent: Commonwealth Energy System

Concord Natural Gas Corporation

Subsidiary: Concord Gas Service Corp.

Consolidated Edison Company of New York, Inc.

Delmarva Power & Light Company

Subsidiaries:

Delmarva Energy Company
Delmarva Industries, Inc.
Delmarva Capital Investments, Inc.
DCI I, Inc.
DCI II, Inc.

Elizabethtown Gas Company

Parent: NUI Corporation

EnergyNorth, Inc.

Subsidiaries:

EnergyNorth Realty, Inc.
Gas Service, Inc.
Energy Resources Corp.
Manchester Gas Co.
Concord Natural Gas Corp.
Concord Gas Service Corp.
Rent-A-Space of New England, Inc.

Essex County Gas Company

Fitchburg Gas & Electric Light Company

Subsidiary: Fitchburg Energy Development Co.

Lynchburg Gas Company

Subsidiary: Lynco Development Corp.

New Jersey Natural Gas Company

Parent: New Jersey Resources Corporation

New York State Electric & Gas Corporation

Subsidiary: Somerset Railroad Corporation

North Carolina Natural Gas Corporation

Subsidiaries:

NCNG Exploration Corp.
Cape Fear Energy Corp.

Northeast Utilities

Subsidiaries:

The Connecticut Light and Power Company
Western Massachusetts Electric Company
Holyoke Water Power Company
Northeast Nuclear Energy Company
The Rocky River Realty Company
The Quinnehtuk Company
Northeast Utilities Service Company

Northern Utilities, Inc. (see Bay State Gas Company)

Pennsylvania Gas & Water Company

Parent: Pennsylvania Enterprises, Inc.

Pequot Gas Co.

Philadelphia Electric Company

Subsidiaries:

Adwin Equipment Company
Adwin Realty Company
Conowingo Power Company
Eastern Pennsylvania Development Company
Eastern Pennsylvania Exploration Company
Philadelphia Electric Power Company
The Susquehanna Electric Company
The Susquehanna Power Company

Philadelphia Gas Works

Providence Gas Company

Parent: Providence Energy Corporation

Public Service Company of North Carolina, Inc.

Subsidiaries:

PSNC Natural Resources Corporation
Tar Heel Energy Corp.
PSNC Production Corp.
PSNC Exploration Corp.
PSNC Propane Corp.

Public Service Electric & Gas Company

Subsidiaries:

Energy Pipeline Corporation
Energy Terminal Services Corporation
Mulberry Street Urban Renewal Corporation
PSE&G Overseas Finance N.V.
PSE&G Research Corporation
Public Services Resources Corp.
Community Energy Alternatives, Inc.
Energy Development Corporation
Gasdel Pipeline System, Inc.

South County Gas Co.

South Jersey Gas Co.

Parent: South Jersey Industries, Inc.

The Southern Connecticut Gas Co.

Parent: Connecticut Energy Corp.

UGI Corporation——

Subsidiaries:

AmeriGas, Inc.
AP Propane
AmeriGas II, Inc.
Schwartz Carbonic Company
Industrial Gases, Inc.
Picar, Inc.
AmeriLease, Inc.
ANSUTECH, Inc.
Matheson Gas Products, Inc.
Matheson Gas Products Canada, Inc.
UGI Development Company
Ashtola Production Company
International Petroleum Service Company
Keystone Oilfield Supply Co.
Stimwell Services Company
B&L Services Company
Universal Well Services, Inc.
Target Cementing Co.
UGID Holding Company
Triad Drilling Company
Union Supply Company
Wellhead Compressor Packagers Company
Wellhead Finance Co.

Cryotex, Inc.
Heavy Media, Inc.
Four Flags Drilling Company, Inc.
Tri-Four, Inc.
UGID Drilling Company
UGID Drilling Investing Company
UGI Ethanol Development Corporation
SAM's Well Service, Inc.
Development Leasing Corporation
Physicians Technology Corporation
Capital Housing, Inc.
Skyten Corporation
UGI Realty Company
UGI Finance N.V.

Valley Gas Co.

Parent: Valley Resources, Inc.

Washington Gas Light Co.

Subsidiaries:

Crab Run Gas Co.
Davenport Insulation, Incorporated
Frederick Gas Co., Inc.
Hampshire Gas Co.
Shenandoah Gas Co.
Brandywood Estates, Inc.
Washington Gas Approved Services, Inc.
Rock Creek Properties, Inc.
Utilitrol

APPENDIX B

AMERICAN PUBLIC GAS ASSOCIATION MEMBER SYSTEMS

ALABAMA

Ashland
Athens
Bay Minette
Bridgeport
Brewton
Calera
Columbiana
Cullman
Decatur
Double Springs
Evergreen
Fairhope
Fayette
Florence
Foley
Ft. Payne
Graysville
Guntersville
Hamilton
Huntsville
Jackson
Lafayette
Loxley
Muscle Shoals
Oneonta
Pleasant Grove
Ragland
Rogersville
Russellville
Scottsboro
Sheffield
Sylacauga
Town Creek
Trussville
Tuscumbia

ARIZONA

Benson
Ft. Defiance
Mesa
Safford

ARKANSAS

Harrisburg

CALIFORNIA

Palo Alto

COLORADO

Center
Rangeley

CONNECTICUT

Norwich

FLORIDA

Chipley
Crescent
Ft. Meade
Ft. Pierce
Jasper
Leesburg
Palatka
Sunrise
Tallahassee
Williston
Winter Garden

GEORGIA

Albany
Americus
Bainbridge
Bowman
Camilla
Covington
Crawfordville
Doerun
Elberton
Fitzgerald
Ft. Valley
Hartwell
Louisville
Lumpkin
Manchester
Millen
Monroe
Moultrie
Pelham
Richland
Social Circle
Sparta
Sugar Hill
Summerville
Sylvester
Thomasville
Tifton
Trion
Union Point
Waynesboro
West Point
Winder
Wrens

ILLINOIS

Anna
Bethany
Bluford
Bushnell
Cairo
Cobden
Fairfield
Marshall
Martinsville
McLeansboro
Norris City
Red Bud
Stonington
Sullivan
Tamms
Westville

INDIANA

Huntingburg
Jasper
Linton

IOWA

Coon Rapids
Emmetsburg
Harlan
Hawarden
Lake Park
Lamoni
Manning
Montezuma
Preston
Remsen
Rock Rapids
Sanborn
Sioux Center
West Bend
Woodbine

KANSAS

Neodesha
Winfield

KENTUCKY

Augusta
Leitchfield
Morgantown
Paintsville
Pikeville
Prestonburg
Richmond

LOUISIANA

Basile
Boyce
Grand Isle
Montgomery

MARYLAND

Easton

MASSACHUSETTS

Holyoke
Middleborough
Wakefield
Westfield

MINNESOTA

New Ulm

MISSISSIPPI

Beaumont
Byhalia
Canton
Corinth
Holly Springs
Pontotoc
Raleigh
Utica

MISSOURI

Green City
Hermann
Milan
Montgomery City
New Florence
New Haven
Potosi
Springfield
Unionville

MONTANA

Shelby

NEBRASKA

Central City
Hastings

NEW MEXICO

Las Cruces
Los Alamos
Socorro

NEW YORK

Bath

NORTH CAROLINA

Bessemer City

OHIO

Hamilton

OKLAHOMA

Guymon
Seiling

PENNSYLVANIA

Chambersburg

SOUTH CAROLINA

Bamberg
Clinton
Greenwood
Orangeburg
Union

SOUTH DAKOTA

Watertown

TENNESSEE

Adamsville
Athens
Bolivar
Brownsville
Clarksville
Covington
Dickson
Erwin
Fayetteville
Gallatin
Halls
Hohenwald
Humboldt
Jackson
Jamestown
Lafayette
Lake City
Lewisburg
Loudon
Madisonville
Memphis
Moscow
Newbern
Oneida
Paris
Pikeville
Portland
Pulaski
Ripley
Rockwood
Rogersville
Savannah
Selmer
Sevierville
Smithville
Smyrna
South Fulton
Springfield
Sweetwater
Tiptonville
Troy
Tullahoma
Waverly
Waynesboro

TEXAS

Benevides
Denver City
Pineland
Robstown
Winona

VIRGINIA

Charlottesville

WASHINGTON

Ellensburg

APPENDIX C

UNITED DISTRIBUTION COMPANIES

1. *Battle Creek Gas Company*

   A wholly owned subsidiary of Southeastern Michigan Gas Enterprises, Inc.

2. *Central Illinois Light Company*

   CILCORP Inc. holds 100 percent of the common stock of Central Illinois Light Company ("CILCO"). CILCO's preferred stock is publicly traded. The common stock of CILCO's parent, CILCORP Inc., is also publicly traded.

3. *Central Illinois Public Service Company*

4. *Citizens Gas & Coke Utility*

   A municipally owned distribution utility.

5. *Citizens Gas Fuel Company*

6. *Consumers Power Company*

   A subsidiary of CMS Energy Corporation, a holding company which is publicly traded.

7. *The Dayton Power and Light Company*

   A wholly owned subsidiary of DPL, Inc., which is publicly traded.

8. *The East Ohio Gas Company*

   A subsidiary of Consolidated Natural Gas Company, a holding company which is publicly traded.

9. *Equitable Gas Company*

   A division of Equitable Resources, Inc., which is publicly traded.

10. *Hope Gas, Inc.*

    A subsidiary of Consolidated Natural Gas Company, a holding company which is publicly traded.

11. *Illinois Power Company*

12. *Indiana Gas Company*

    A subsidiary of Indiana Energy, Inc., a holding company which is publicly traded.

13. *Kokomo Gas and Fuel Company*

14. *Michigan Gas Company*

    A wholly owned subsidiary of Southeastern Michigan Gas Enterprises, Inc.

15. *Michigan Gas Utilities Company*

    A subsidiary of Michigan Energy Resources, Inc., a holding company which is publicly traded.

16. *National Fuel Gas Distribution Corporation*

    Parent: National Fuel Gas Company, a public utility holding company.

17. *Niagara Mohawk Power Corporation*

18. *North Shore Gas Company*

    A subsidiary of Peoples Energy Corporation.

19. *Ohio Gas Company*

20. *Orange & Rockland Utilities, Inc.*

21. *The Peoples Gas Light and Coke Company*

    A subsidiary of Peoples Energy Corporation.

22. *The Peoples Natural Gas Company*

    A subsidiary of Consolidated Natural Gas Company, a holding company which is publicly traded.

23. *Richmond Gas Corporation*

24. *The River Gas Company*

A subsidiary of Consolidated Natural Gas Company, a holding company which is publicly traded.

25. *Rochester Gas and Electric Corporation*

26. *Southeastern Michigan Gas Company*

A wholly owned subsidiary of Southeastern Michigan Gas Enterprises, Inc.

27. *Union Electric Company*

28. *West Ohio Gas Company*

A subsidiary of Consolidated Natural Gas Company, a holding company which is publicly traded.

29. *Wisconsin Fuel and Light Company*

30. *Wisconsin Gas Company*

A subsidiary of WICOR, Inc., which is publicly traded. Also, one series of preferred stock issued by Wisconsin Gas Company is publicly traded.

31. *Wisconsin Natural Gas Company*

All of the common stock of Wisconsin Natural Gas Company is owned by Wisconsin Energy Corporation, which is publicly traded.

32. *Wisconsin Southern Gas Company*

APPENDIX D

[Excerpts from Joint Comments of Indicated Producers]

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RM87-34-000

REGULATION OF NATURAL GAS PIPELINES AFTER PARTIAL WELLHEAD DECONTROL

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October 13, 1987

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MOBIL PRODUCING TEXAS & NEW MEXICO INC.
MOBIL EXPLORATION AND PRODUCING
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* * * *

B. The Crediting Mechanism Is Unduly Discriminatory, Contravening Section 5 Of The NGA.

The Commission has no authority to adopt rules that are unduly discriminatory.[12] The crediting mechanism causes undue discrimination among all segments of the natural gas industry, including buyers, sellers, shippers and pipelines. In Order No. 436, the Commission rejected conditioning producer access because:

> [C]onditioning producer access on take-or-pay relief would be inconsistent with the non-discrimination requirements of both Order No. 436 and the Natural Gas Act.[13]

That statement remains valid. *Associated Gas Distributors* v. *FERC*, *supra*, is not to the contrary. The Court therein merely indicated that the Commission had not provided sufficient explanation why a conditioned access scheme would be unduly discriminatory.[14] The Commission is obliged to consider anti-competitive issues in its proceedings.[15] It did not do so. Instead, the Commission ignored the anti-competitive impact of the crediting mechanism.

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[12] *See* Section 5 of the NGA, 15 U.S.C. § 717d.

[13] Order No. 436-A at 35.

[14] Associated Gas Distributors v. FERC, *supra*, slip opinion at 92-93.

[15] Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. (1985).

IV. THE COMMISSION SHOULD REITERATE ITS VIEW THAT ITS POWERS UNDER SECTION 5 OF THE NGA SHOULD NOT BE USED TO REVISE TAKE-OR-PAY PROVISIONS.

A. The Commission's Decision In Order No. 436 Was Correct.

In vacating and remanding Order No. 436, the District of Columbia Circuit directed the Commission to "reassess its refusal to act under § 5" of the NGA [79] with respect to natural gas still subject to the NGA.[80] Accordingly, the Commission specifically requested comments addressing whether it "should invoke its powers under NGA section 5 to modify or set aside jurisdictional contracts with troublesome take-or-pay provisions." [81] The Court did not direct the Commission to invoke Section 5. Rather, it directed the Commission only to "reassess" its decision not to do so. Upon reassessment, the Commission should reaffirm its original determination not to take the "extreme measure" of invoking Section 5.[82]

* * * *

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[79] 15 U.S.C. § 717d.

[80] Associated Gas Distributors v. FERC, *supra*, slip opinion at 91.

[81] Order No. 500, slip opinion at 30-31. It should be noted that the issue revolves around jurisdictional natural gas, not "jurisdictional contracts." Many natural gas sales contracts cover both gas still subject to the NGA and gas not subject to the NGA. For such contracts the issue is whether the Commission should invoke Section 5 to modify or abrogate the take-or-pay provisions to the extent the provisions cover the natural gas still subject to the NGA.

[82] The *AGD* Court noted that the "[u]nilateral abrogation of a contract is an extreme measure." Associated Gas Distributors v. FERC, *supra*, slip opinion at 66.

Supreme Court, U.S.
FILED
MAR 16 1988
JOSEPH F. SPANIOL, JR.
CLERK

Nos. 87-978, 87-1091

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OFFSHORE, INC., *et al.*,
Petitioners,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF IN OPPOSITION OF TENNESSEE GAS PIPELINE COMPANY

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March 16, 1988

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

Nos. 87-978, 87-1091

SHELL OFFSHORE, INC., *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION OF TENNESSEE GAS PIPELINE COMPANY

Five petitions for writs of certiorari seek review of discrete aspects of *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (*AGD*). In No. 87-978, *Shell Offshore, Inc. v. FERC*, certain producers of natural gas ("Producers") jointly seek reversal of the court of appeals' remand for reconsideration of the Commission's refusal in FERC Order No. 436 to mitigate the impact on interstate pipelines' take-or-pay liabilities of requiring such pipelines to transport gas, as open-access carriers,

that displaces pipeline sales. Tennessee Gas Pipeline Company (Tennessee) opposes this petition.[1]

In No. 87-1091, *Southern California Gas Co. v. FERC*, a local distribution company (SoCal) seeks review of that portion of *AGD* that upholds alternative procedures adopted in Order No. 436 to expedite the approval of applications for certificates under section 7 of the Natural Gas Act (NGA), 15 U.S.C. § 717f, to provide new services and construct new facilities. Tennessee opposes SoCal's petition insofar as it requests an advisory opinion on the line of demarcation between interstate transportation of natural gas subject to the Commission's NGA jurisdiction and the local distribution of natural gas subject to regulation by the states.

STATEMENT OF THE CASE

Take-or-pay provisions in gas supply contracts between interstate pipelines and producers of natural gas have led to serious "market disorders" in the natural gas industry since the enactment of the Natural Gas Policy Act (NGPA) in 1978.[2] Between 1978 and 1982, interstate gas pipelines, emerging from the severe shortages and curtailments of the 1970's, contracted for available gas reserves to meet customer requirements and replenish declining inventories.[3] Because the demand for

[1] Tennessee Gas Pipeline Company is a wholly-owned subsidiary of Tenneco Inc. Throughout this brief, references to the Appendix in No. 87-978 are cited as App. ——. Emphasis is supplied throughout this brief unless otherwise noted.

[2] The Commission so found when it initiated the rulemaking which led to the promulgation of Order No. 436. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Notice of Proposed Rulemaking, 50 Fed. Reg. 24,130 (1985), [1982-1987 Proposed Regs. Transfer Binder] F.E.R.C. Stats. and Regs. (CCH) ¶ 33,100 at 33,105-06 (1985).

[3] The Commission requires that pipelines maintain adequate supplies to meet their service obligations reflected in certificates issued pursuant to § 7 of the NGA. *See, e.g.*, United Gas Pipe Line Co.

reserves far exceeded supply, such reserves commanded the maximum lawful prices allowed by the NGPA for price-regulated gas and still higher prices for deregulated gas. Producers also typically obtained onerous quantity provisions, which obligated their pipeline-purchasers to take, or pay for, a very high percentage (typically 75 percent to 95 percent) of the producer's delivery capability. Interstate pipelines had no choice but to accept these burdensome terms in order to meet their contractual and certificated sales obligations to their customers:

> *All* the interstate pipelines bid supra-market prices for gas in 1978-82. A natural question is what would have happened to a pipeline that refused to do so. The answer is—Disaster. Any pipeline that limited its bids to true market prices would have found itself short of gas and almost certainly in breach of both contractual and regulatory duties to supply gas. With rolled-in prices and the NGPA system of wellhead price controls, it was a mathematical *necessity*, for the natural gas market to clear, that some gas be bought at prices above market levels.

Williams, *The Proposed Sea-Changes In Natural Gas Regulation*, 6 Energy L. J. 233, 237 (1985) (emphasis in original).

Since 1982, however, the gas market has moved from shortage to surplus. The Commission has traced the surplus to a decline in consumption caused by conservation, recession, loss of heavy manufacturing, fuel switching (due to the collapse of world oil prices)[4] and

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v. FERC, 597 F.2d 581, 588 (5th Cir. 1979), *cert. denied*, 445 U.S. 916 (1980); Amoco Production Co., 23 F.E.R.C. (CCH) ¶ 61,211 at 61,433 (1983).

[4] *See* Impact of Special Marketing Programs on Natural Gas Companies and Consumers, Notice of Inquiry, 49 Fed. Reg. 3193, IV F.E.R.C. Stats. & Regs. (CCH) ¶ 35,513 (1984).

a substantial increase in deliverability from existing reserves.[5] This surplus gas became available on the "spot market" at prices below the average cost of pipeline system supply under long-term contract. Order No. 436 allows producers to channel their uncommitted, surplus gas into pipeline sales markets at reduced prices. At the same time, producers demand that pipelines pay for gas that the pipelines are unable to take under existing higher-priced long-term contracts because the market has been displaced by the producers' lower-priced, surplus gas. Thus, Order No. 436 creates unprecedented, multi-billion dollar take-or-pay problems for interstate pipelines.[6] Therein lies the rub.

Order No. 436 restructures the natural gas industry by forcing interstate pipelines to become "open access" transporters of gas sold by producers to local distribution companies (LDCs) and end-users who previously relied almost exclusively on interstate pipelines for their gas supply.[7] However, Order No. 436 did not relieve inter-

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[5] The NGPA particularly spurred developmental drilling (that is, the drilling of new wells on existing reserves to increase production) rather than exploratory drilling for new reserves. *See* Notice of Inquiry, n.4, *supra*. For example, between 1978 and 1983, Transcontinental Gas Pipe Line Corporation's dedicated reserves increased by 3 percent, while deliverability under its supply contracts increased 140 percent. Hearings before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. (October, 1983) (Statement of Brian O'Neill).

[6] Estimates of accrued take-or-pay in 1985 were approximately $7 billion. App. at 75a. Producers assert that Order No. 436 is resolving the problem. (Pet. Br. at 20) However, producers own figures underscore the severity of the problem. Despite having paid producers $200 million in 1985 and $700 million in 1986 plus non-cash concessions, pipelines continue to incur over $6 billion dollars of additional take-or-pay annually. The $700 million is just the tip of the iceberg.

[7] See the petitioners' statements of the case in Interstate Natural Gas Assoc. v. FERC, No. 87-976; Texas Eastern Transmission Corp. v. FERC, No. 87-977; and City of Willcox v. FERC, No. 87-979. These petitions seek review of the Order No. 436 open-access provi-

state pipelines of their traditional merchant role. Because of the Commission's concern for security of supply, pipelines are required to maintain a sufficient supply of gas to meet their certificated service obligations to their customers.[8] This, in turn, requires pipelines to maintain their long-term contracts with gas producers which contain provisions that obligate pipelines to pay for certain minimum volumes of gas whether or not taken. Pipeline customers, however, no longer are obligated to purchase a minimum amount of gas from their pipeline suppliers.[9] Thus, as explained previously, Order No. 436 allows producers to sell surplus "spot market" gas and other uncommitted supplies to pipeline customers while requiring pipelines to take or pay for long-term gas purchased to serve the same customers. Under current surplus conditions, producers have successfully displaced pipeline sales with spot market gas. Published reports estimate that nearly 70 percent of interstate gas transmission is transportation of gas for others rather than pipeline sales.[10]

In Order No. 436, the Commission refused to adopt affirmative remedies to mitigate the build-up of take-or-pay liability under producer-pipeline gas supply contracts caused by its open access transportation program. The Commission told pipelines to buy their way out of their obligations to producers and attempt to pass these payments downstream to their ratepayers in individual rate cases. *See* App. at 80a-85a. In so doing, the Commission

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sion on the ground that it reflects the unlawful imposition of common carriage on interstate pipelines.

[8] *See* the discussion at n.3, *supra*. Pipelines earn no profit on their gas inventories; they are required to resell their gas at cost.

[9] *See* Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1148 (1986) (affirming FERC Order No. 380, which required interstate pipelines to eliminate gas cost minimum bills from their rate schedules).

[10] Foster's Natural Gas Reports, Feb. 25, 1988 at 15.

made no real assessment of pipelines' abilities to arrange such buy-outs, the aggregate cost of pipelines' buying out of these obligations, the effect of such buy-outs on LDC supply security and the rate impact on ultimate consumers. Moreover, Order No. 436 removed the pipelines' principal bargaining chip to mitigate the cost of resolving take-or-pay problems—the ability to trade transportation for renegotiation of "problem" contracts. *See* App. at 81a.

On review of Order No. 436 in *AGD*, the court of appeals upheld the Commission's authority to impose open-access, common carriage obligations on interstate pipelines. However, it found that the Commission's treatment of the take-or-pay issue did not meet the requirement of "reasoned decisionmaking." The court of appeals identified the three premises upon which the Commission's refusal to act was based: (1) Order No. 436 would not cause take-or-pay liabilities to increase; (2) certain policy considerations militated against regulatory relief; and (3) the most obvious remedies (exercise of NGA § 5 power to modify unjust and unreasonable take-or-pay provisions, and limitations on open access with respect to producers that refused to cooperate in mitigating the impact of Order No. 436 on pipeline take-or-pay) were flawed. App. at 80a. It remanded Order No. 436 because the first and third premises were insupportable.

The court of appeals explained in great detail why it could not accept the Commission's assertion that Order No. 436 would not increase pipeline take-or-pay exposure and make it more difficult and expensive for pipelines to resolve these liabilities. App. at 80a-86a. It concluded that "FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability . . . seem[s] impossible to square with the requirement of reasoned decisionmaking. App. at 84a.

The court of appeals also found fatal weaknesses in the reasons offered by the Commission for rejecting the

major alternatives supported by virtually all state regulatory agency and LDC representatives. App. at 89a-94a. The court found the Commission's explanation of its rejection of section 5 action to be so unclear that meaningful review was impossible. App. at 90a. The court similarly found wholly implausible the Commission's assertion that any limitation on open access would be unduly discriminatory under the NGA. App. at 91a-92a. Thus, it remanded the case to the Commission for further explanation. App. at 124a.

REASONS WHY THE WRITS SHOULD NOT BE GRANTED

I. THE PRODUCERS' PETITION IS NOT RIPE FOR REVIEW

To be sure, Order No. 436 is of enormous significance to all segments of the natural gas industry. But that does not mean that all of the petitions raise issues that are worthy of review by this Court. Producers' petition differs sharply from the Interstate Pipeline petitions (cited in note 7) in its fitness for review by the Court. The open access regulations challenged by the Interstate Pipelines are final and in effect; their legality has been determined subject only to review by this Court.[11] By contrast, the court of appeals did not finally determine that the Commission was required to adopt specific take-or-pay mitigating measures as part of the restructuring of its regulation of natural gas companies. The majority opinion stressed repeatedly that it was not ordering the Commission to adopt a particular

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[11] In *AGD*, the court of appeals upheld the open access requirement of Order No. 436 pipelines, and the Commission has repromulgated this requirement intact. FERC Order No. 500, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (August 14, 1987), III. F.E.R.C. Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,761 (1987).

remedy.[12] Rather, it was remanding because the Commission did not express its reasons "clearly enough for [the court of appeals] to determine the legality of its analysis." App. at 90a.

The Commission has not dissented from this course; it has not asked this Court to review the decision below or to relieve it from the judgment. To the contrary, it has instituted a new proceeding in which it intends to examine fully the extent of the take-or-pay problem and explore the need for additional Commission action.[13] It also has issued *interim* regulations that attempt in a limited way to restore the pre-Order No. 436 *status quo* insofar as take-or-pay build-up is concerned.[14] Under the circumstances, review of this aspect of the *AGD* decision below is unwarranted.

In light of the strong judicial policy against piecemeal review[15], the Court does not grant certiorari to review a non-final judgment such as a remand order in the absence of special circumstances that require the Court to intercede. *See Brotherhood of Locomotive Firemen v.*

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[12] App. at 90a, 92a, 94a and 124(a) ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking." App. at 94a).

[13] As part of Order No. 500, *supra*, n.11, the Commission invited public comments on a range of permanent options to address the take-or-pay impact of open access transportation, and stated that it would use its statutory authority to collect comprehensive data on take-or-pay. F.E.R.C. Stats. & Regs. (CCH), *supra*, at 30,784, 30,799-800. The Producers have been and doubtless will continue to be active participants in that proceeding.

[14] The FERC Order No. 500 regulations provide, as an interim measure, that producers give open access pipelines volumetric credit against take-or-pay obligations for each Mcf of gas transported for that producer. *See* Order No. 500, *supra*, n. 11; Order Explaining Crediting Provisions, 41 F.E.R.C. (CCH) ¶ 61,025 (1987).

[15] *See, e.g.*, Olson v. Paine, Webber, Jackson & Curtis, Inc., 806 F.2d 731, 733 (7th Cir. 1986).

Bangor & Aroostook Railroad Co., 389 U.S. 327, 328 (1967); *Hamilton-Brown Shoe Co. v. Wolf Brothers & Co.*, 240 U.S. 251, 258 (1916). No special circumstances warrant review of the court of appeals' remand on the take-or-pay issue. The facts and circumstances strongly counsel against premature review of the remand order.

First, Producers' petition does not challenge the legality of specific regulations or decisions of the Commission. Instead, Producers request the Court to issue an advisory opinion that the Commission has no authority whatsoever to mitigate the build up of take-or-pay caused by open access transportation under Order No. 436.[16]

Producers' legal challenge lacks the concreteness necessary for review by the Court.[17] For example, the court of appeals discussed generically, under the heading "conditioning producer access", proposals for mitigation of take-or-pay, which differed in their specific elements. App. at 91a. Some requested no more than a declaration by the Commission that it is not unduly discriminatory *per se* for an open access pipeline to negotiate and obtain take-or-pay credit equal to the quantity of gas that a producer wants to sell and have transported to the pipeline's tradi-

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[16] The Commission has not defended Order No. 436 on the ground that it lacked authority to take affirmative action to mitigate the take-or-pay problem. Although it suggested at one time that it might not have authority, it moved away from that position on rehearing and repudiated it in its brief to the court of appeals. App. at 93a. Thus, Producers objections at pages 9-15 of their petition go to the court of appeals' rejection of their attempt to support the Commission's order on grounds that the Commission did not rely on for its decision.

[17] The Court's opinion in Chevron, U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984), presumes that the agency will have provided an explication of its statutory authority in the first instance. Because of the context in which Producers' challenge arises, the Court does not have the benefit of an in-depth analysis by the Commission of its statutory authority to mitigate the impact of Order No. 436 on interstate pipelines.

tional sales customers. Others would have required producers to renegotiate above-market "problem contracts" with all interstate pipelines in order to obtain open access transportation on any pipeline's system. Obviously, these proposals would have very different impacts on the affected parties and implicate different values. Yet, Producers would have the Court condemn all possible actions by the Commission that might affect producer contracts without any consideration of the qualitative and quantitative difference of various proposals. If, on remand from the decision below, the Commission adopts final rules that adversely affect producer interests, they will have a full opportunity to contest the legality of the case-specific actions.[18]

Second, the outcome of the Commission proceedings on remand is hardly a foregone conclusion, and may eliminate Court review. In Order No. 500, the Commission did not exercise its authority under section 5 of the NGA to modify jurisdictional producer-pipeline contracts; nor did it broadly order producers to abrogate their above-market contracts or lower their prices under such contracts. The Commission adopted a limited, temporary remedy *pendente lite*. *See* FERC Order No. 500, *supra*, n. 11. Producers have filed comments in that proceeding which challenge the legality and wisdom of take-or-pay crediting, and the Commission has the matter under advisement.

Third, regardless of the outcome of the Commission's proceeding on remand, further judicial review will be based upon a far more complete record than the patently inadequate record in the Order No. 436 proceeding. The court of appeals rightly described the Commission's fac-

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[18] Several of the petitioners in No. 87-978 have appealed the interim take-or-pay crediting procedures of FERC Order No. 500 to the United States Court of Appeals for the Fifth Circuit. That proceeding provides an additional forum in which to contest in a concrete setting the Commission's exercise of its NGA jurisdiction.

tual assessment to be "utterly Panglossian." [19] After promulgating Order No. 436, the Commission admitted to Congress that it did not have the data to assess the extent of the existing take-or-pay problem.[20] On remand, the Commission has exercised its authority under the NGA and the NGPA to obtain data on the extent of the take-or-pay problem.[21] Correction of this glaring omission can only aid the administrative and judicial process.

II. THE COURT OF APPEALS PROPERLY REMANDED THE PROCEEDING TO THE COMMISSION FOR FURTHER CONSIDERATION

In light of our strongly held belief that review by this Court is premature, we ordinarily would not address the question whether the remand order was correct on the

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[19] App. at 94a. *See* App. at 81a-84a ("FERC offers nothing to undermine the challengers' inherently plausible suggestion that [the Order No. 436 open access] conditions will have an adverse impact on the pipelines' take-or-pay problems.")

[20] In April, 1986, the Commission admitted in a letter to members of the Government Operations Committee of the House of Representatives, that it had very little idea of the extent to which pipeline operations had been or would be affected by actual or potential take-or-pay liability. The Commission stated that data submitted under current regulations "do not provide sufficient information to assess the current magnitude of these [take-or-pay] liabilities." The Members asked whether the Commission had solicited data with respect to take-or-pay obligations in the rulemaking and whether it had data to assess the extent to which Order No. 436 would increase pipelines' take-or-pay exposure. The Commission answered, "there are no data on the extent to which Order No. 436 may increase pipeline take-or-pay exposure." This letter is reprinted in the Supplemental Appendix to this brief.

[21] In FERC Order No. 500, *supra*, n.11, the Commission announced it was requiring each interstate natural gas pipeline company to respond to an extremely detailed data request "to determine the extent and nature of pipelines' take-or-pay obligations with respect to the various NGPA pricing categories." The Commission stated that it would "aggregate the data and analyze it promptly." F.E.R.C. Stats. & Regs. (CCH) at 30,784.

merits. However, Producers' petition could be construed to argue that the decision below is so obviously wrong that further proceedings are clearly unnecessary. We, therefore, demonstrate below that the court of appeals' decision is well grounded in law and policy.

A. The Court of Appeals Correctly Affirmed the Commission's Authority Under the Natural Gas Act to Remove Barriers That Prevent the Efficient Functioning of Gas Markets

Producers argue that the *AGD* decision unjustifiably authorizes the Commission to deny "access to transportation for many producers. . . ." (Pet. Br. at 10) However, neither the NGPA nor the NGA mandate that interstate pipelines must transport gas sold by producers to pipeline sales customers in transactions that displace pipelines' sales and create take-or-pay liability. App. at 93a-94a. In Order No. 436, the Commission mandated open access as an exercise of its power to condition the authority of pipelines to transport gas under section 7 of the Natural Gas Act, 15 U.S.C. § 717e, and section 311 of the Natural Gas Policy Act, 15 U.S.C. § 3371. If the Commission's NGA and NGPA powers allow it to impose open access conditions on interstate pipelines,[22] then the Commission similarly may place qualifications on open access as a transitional measure to mitigate the build-up of take-or-pay costs and encourage the renegotiation of such barriers to the efficient operation of gas markets.

1. *The Commission Has Plenary Jurisdiction Over The Transportation of Natural Gas*

Although the NGPA withdrew the Commission's authority to establish wellhead prices and to regulate so-called "first sales" of natural gas, it reaffirmed the Commission's plenary jurisdiction over the *transportation* of

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[22] Nos. 87-976, 87-977 and 87-979 seek Court review of the legality of the open access requirement.

natural gas pursuant to sections 1(b) and 7 of the NGA, 15 U.S.C. §§ 717(b), 717f, and section 311 of the NGPA, 15 U.S.C. § 3371.[23]

Any doubt as to the Commission's continuing plenary jurisdiction over interstate transportation is dispelled by the legislative history of the NGPA. The Explanatory Statement of the House Managers of the conference bill that became the NGPA emphasizes that:

> FERC retains its transportation certification authority under section 7 of the Natural Gas Act. The authority was relied upon by both FERC and its predecessor, the FPC, to impose a wide range of conditions upon the transportation of gas in interstate commerce. This authority remains intact . . . .[24]

Producers claim that the court of appeals ignored the limitations placed on the Commission's transportation jurisdiction by section 601(c)(1) of the NGPA, 15 U.S.C.

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[23] Section 1(b) of the NGA gives the Commission jurisdiction over (1) the transportation of natural gas in interstate commerce, (2) the sale for resale of natural gas in interstate commerce and (3) natural gas companies engaged in such sales or transportation. Each of these grants in an independent, albeit often overlapping fount of authority. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 636 (1972); FPC v. East Ohio Gas Co., 338 U.S. 464, 468-69 (1950). In integrating the NGPA with the NGA, Congress actually expanded the Commission's jurisdiction over gas transportation. Pursuant to NGPA § 601(a)(2), 15 U.S.C. § 3431(a)(2), the Commission's *NGA* transportation jurisdiction was modified only with respect to the extraordinary presidential authority contained in NGPA §§ 302 and 303 and to acknowledge the additional grant of authority in NGPA § 311 over certain transportation by intrastate and interstate pipelines. Notably, § 311(c), in virtually the same terms as NGA § 7(e), authorizes the FERC to approve qualifying transportation arrangements "under such terms and conditions as the Commission may prescribe." 15 U.S.C. § 3371(c).

[24] 124 Cong. Rec. H13119. Notably, in their brief to the court of appeals (at 20), Producers described the Explanatory Statement as the "strongest type of legislative interpretation."

§ 3431(c)(1).[25] However, producers did *not* argue below that Section 601(c)(1) placed substantive limits on the Commission's authority to mitigate the impact of Order No. 436 on pipeline take or pay. Section 601(c)(1) is irrelevant to the access condition considered in *AGD*. By imposing an access condition, the *Commission* would *not* be denying any pipeline the right to apply for and receive a certificate to transport for any person "based upon the amount paid in any sale of gas."[26] Rather, such a condition would allow a *pipeline* to obtain reasonable take-or-pay relief (as defined by the Commission) from those producers that want the privilege of gaining access to the pipeline's system. As the court of appeals correctly observed, neither the NGA nor the NGPA mandate that producers be granted unfettered access to interstate transportation and enjoy the new market opportunities thereby created. App. at 93a-94a.

An access condition is fully consistent with the Congressional intent of the NGPA. While Congress envisioned that wellhead prices would be determined by market forces, it was legislating against a background in which the buyers in that market consisted largely of interstate pipelines. Order No. 436 fundamentally changes market conditions and benefits producers by adding new buyers to the market. The decision below recognizes that the NGA and NGPA do not require the Commission to create new market opportunities for producers. An ac-

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[25] Section 601(c)(1) provides under the heading "Guaranteed passthrough" that: "The Commission may not deny, or condition the grant of, any certificate under Section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable. . . ."

[26] Subsequent to the NGPA and prior to Order No. 436, the Commission routinely attached conditions to certificates which limited the gas eligible for transportation (including limitations based on price) without serious challenge to their validity. *See, e.g.*, Tenneco Oil Co., 29 F.E.R.C. (CCH) ¶ 61,334 at 61,700 (1984); Tenneco Oil Co., 26 F.E.R.C. (CCH) ¶ 61,030 at 61,072 (1984).

cess condition, such as take-or-pay crediting, allows pipelines to make the transition to these new market circumstances.

2. *The NGPA Does Not Bar The Commission's Exercise Of its Authority To Modify Non-Price Terms In Jurisdictional Contracts*

In the NGPA, Congress removed certificate jurisdiction over producer-pipeline sales of "new" and price-deregulated gas.[27] But it retained certificate jurisdiction—and, hence, NGA § 5 authority[28]—over producer-pipeline sales of so-called "old" gas. The court of appeals described this as "perfectly standard grandfathering." App. at 90a.

Producers nonetheless contend that the Commission is prohibited from exercising its NGA § 5 authority to mitigate high take-or-pay provisions in *jurisdictional* producer-pipeline contracts because such provisions interact with contractual price provisions to prevent the efficient functioning of the gas market.[29] But such authority, if

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[27] Section 601(a)(1), of the NGPA, 15 U.S.C. § 3431(a)(1), sets forth the categories of gas sales that are no longer subject to NGA sales jurisdiction.

[28] Section 5 of the NGA, 15 U.S.C. § 717d, provides in pertinent part that whenever the Commission finds that "any rule, regulation, practice or contract" subject to its transportation or sales jurisdiction "is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable . . . rule, regulation, practice or contract to be thereafter observed and in force, and shall fix the same by order . . . ."

[29] Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982), cited at page 12 n.33 of Producers petition, is inapposite. That case dealt only with the question of the Commission's authority to interpret the rate-setting provisions of *non-jurisdictional contracts*—those contracts that Congress removed from the Commission's NGA sales certificate jurisdiction. Nor does Office of Consumer Counsel v. FERC, 783 F.2d 206 (D.C. Cir. 1986) (cited at page 10 n.25 of Producers' petition) support Producers' claim. To the contrary, the court of appeals upheld a

exercised,[30] would not prescribe price levels or require producers to charge any particular price. Above-market contract prices are problematic only where the contract requires the pipeline to take or pay for the gas without regard to market price. The Commission found in Order No. 436 that such take-or-pay provisions prevent the development of an efficient, competitive market for natural gas at the wellhead.[31]

By reducing to just and reasonable levels the maximum obligations of pipelines to take gas under jurisdictional contracts entered into during the gas shortage, the Commission would be creating *market conditions* which allow *market forces* to determine whether the contract price is too high. Thus, a Commission decision to exercise its NGA § 5 authority to modify non-price provisions in pre-NGPA contracts over which it has jurisdiction because they impede the transition to a competitive market would be fully consistent with the specific language of section 5 and with Congressional intent. *Cf. Conway Corp. v. FPC*, 510 F.2d 1264, 1270-72 (D.C. Cir. 1975), *affirmed*, 426 U.S. 271, 279 (1976).

B. In Remanding the Case to the Commission the Court of Appeals Correctly Applied the Arbitrary-and-Capricious Test

Invoking this Court's *Chevron* decision,[32] Producers accuse the court of appeals of failing to defer to the Com-

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Commission finding that certain take-or-pay clauses in producer-pipeline contracts had become unjust and unreasonable under section 5 of the NGA.

[30] Again, Producers challenge is hypothetical. The court of appeals did not direct the Commission to exercise its NGA § 5 power and the Commission has not done so.

[31] The court of appeals observed that "the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure." App. at 91.

[32] Chevron, U.S.A. v. Natural Resources Defense Council, *supra*, 467 U.S. 837.

mission's decision. However, *Chevron* should not become "a talisman under which any agency decision is by definition unimpeachable." *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 50 (1983) (*"State Farm"*). Producers do not raise any issues of administrative law that require the Court to exercise supervisory authority over the court below. The Commission has neither complained that its authority has been usurped nor sought Court review of the remand order. Review is sought by those who would take advantage of the market opportunities of Order No. 436 to sell less expensive "spot market" gas into traditional pipeline sales markets and require pipelines to take or pay for more expensive long-term gas supply acquired to meet their sales obligations under certificates issued by the Commission.

In remanding the case to the Commission, the court of appeals properly applied this Court's teaching in *State Farm* to set aside arbitrary and capricious agency action. *Id.* at 42-43. The court of appeals correctly identified the three premises upon which the Commission's refusal to act was based: (1) Order No. 436 would not cause take-or-pay liabilities to increase; (2) certain policy considerations militated against regulatory relief; and (3) the most prominent remedies (exercise of NGA § 5 power to modify unjust and unreasonable take-or-pay provisions; and limitations on open access where producers refuse to cooperate in mitigating the impact of Order No. 436 on pipeline take-or-pay) were flawed. App. at 80a. It remanded Order No. 436 because the first and third premises were wholly insupportable. App. at 81a-86a, 89a-94a.

The court of appeals explained in great detail why it could not accept the Commission's assertion that Order No. 436 would not increase pipeline take-or-pay exposure and make the resolution of these liabilities more difficult and expensive. App. at 80a-86a. It concluded that

"FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability . . . seem[s] impossible to square with the requirement of reasoned decisionmaking." App. at 84a. The Court's analysis is amply supported by the Commission's subsequent admission that it had no reliable information on the extent of the take-or-pay problem and its action in Order No. 500 to obtain this critical data.[33] Producers do not attempt to rebut the court's careful analysis, but instead offer various excuses for the Commission's "utterly Panglossian" factual assessment. But reasoned decisionmaking requires more than a "minimum rationality." *State Farm, supra,* 463 U.S. at 42 n.9. The court of appeals was not required to accept uncritically an explanation that "runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Id.* at 43.[34]

The court of appeals also identified fatal weaknesses in the reasons offered by the Commission for rejecting the significant alternatives to its no-action course. App. at 89a-94a. It found the Commission's explanation of the reasons for its rejection of Section 5 action to be so unclear and lacking in content that the legality of the Commission's analysis could not be reviewed. App. at 90a. While remanding for further consideration, the majority opinion even suggested possible justifications to the Commission in support of its refusal to exercise its section 5 power. *Id.* This is hardly indicative of a court whose purpose and intent is to substitute its judgment for the agency's.

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[33] *See* n.20 & 21, *supra,* and accompanying text.

[34] Nor can the Commission's actions be defended by arguing that the dimensions of the take-or-pay problem were uncertain. It was incumbent upon the Commission to explain the reason why it was necessary to act without "engaging in a search for further evidence." State Farm, *supra,* 463 U.S. at 52.

The court of appeals similarly found implausible the Commission's primary reason for refusing to consider some form of take-or-pay relief in return for giving producers the privilege of access to pipeline systems—the claim that such a refusal would always be unduly discriminatory. The court stated:

> Given that the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure, it eludes us why pipeline denial of access to producers that stand on the letter of their contract rights should be viewed as unduly discriminatory. It is clear that § 5 does not prohibit every distinction. FERC offers no reason why it views this one as beyond the pale.

App. at 91a-92a (citations omitted).

Producers again do not address the court of appeals analysis; they merely repeat the Commission's claim that any policy other than unrestricted access to interstate transportation is unduly discriminatory, and cite the other policy considerations raised by the Commission. (Pet. Br. at 18-19) But the court of appeals was not required to speculate whether the Commission's other policy considerations would tip the scales in favor of nonintervention in the absence of an unjustified concern that restricting access would be unduly discriminatory on its face. It properly remanded in order to allow the Commission to determine "to what extent these policy considerations may justify its inaction on the uneconomical producer-pipeline contracts." App. at 94a.

III. THE COURT SHOULD NOT RENDER AN ADVISORY OPINION ON THE SCOPE OF THE STATES' JURISDICTION OVER THE INTERSTATE TRANSPORTATION OF NATURAL GAS

SoCal's petition in No. 87-1091 challenges the Commission's authority to adopt Optional Expedite (OEC) procedures to process applications for certificates. In decid-

ing whether to issue an OEC, the Commission stated it would not consider factors that have traditionally been used to justify denial of certificates—particularly duplication of facilities and the impact on the LDC of transactions in which interstate pipelines propose to transport gas directly to end-users without utilizing the facilities of the local distribution company (the so-called "bypass issue"). *See* App. at 102a.

In Part III of its petition, SoCal argues that the Court must review the *AGD* decision in order to declare that the states have the authority to regulate the interstate transportation of gas by an interstate pipeline at some point prior to the point at which the gas is received by the customer. SoCal claims this jurisdictional issue is ripe for review because the Commission and the court of appeals relied on the existence of the authority of the states to regulate such interstate transportation of gas, and establish their own certification standards, to determine that the Commission could change its certification policies. (SoCal Br. at 11) Tennessee opposes SoCal's request for clarification.

SoCal's argument concerning the need to "clarify" the scope of state jurisdiction rests on a fundamental misreading of Order No. 436 and the *AGD* decision. *AGD* did not uphold the OEC regulations on the ground that the states have comparable authority to impose their own certification requirements and veto or re-arrange a transportation proposal that would bypass an LDC. The Commission and the court of appeals concluded that where the applicant for a certificate must assume the full economic risk of the venture, the risk of wasteful bypass is remote.[35] While the Commission in Order No. 436 and

[35] App. at 104a. The court explained in detail that the risk of bypass largely is a function of *rate* policies established by state regulatory agencies that allow LDCs to extract from disfavored customers "a disproportionate share of [the LDC's] costs." App. at 106a.

the court in *AGD* referred to the authority of the states to control direct sales,[36] neither Order No. 436 nor the *AGD* decision purport to establish the bounds of state jurisdiction. The court of appeals stated that: "The exact scope of this power is unplumbed and is not before us now." App. at 106a.

The Court does not have before it an actual case or controversy in which the FERC has issued a certificate to an applicant for the interstate transportation of gas into a state over the objection of a state agency which maintains that it has jurisdiction to regulate the transaction. SoCal asks this Court to venture an advisory opinion without a specific factual anchor and the detailed maps provided by agency and appellate decisions concerning the respective Constitutional and statutory allocation of regulatory authority between the FERC and state regulatory agencies. This is "too remote and abstract an inquiry for the proper exercise of the judicial function." *International Longshoreman's and Warehouseman's Union, Local 37 v. Boyd*, 347 U.S. 222, 224 (1954).

The issue before the Court is not whether the Commission's decision to de-emphasize certain factors in certificate proceedings is justified because the states can assume the regulatory mantle; the issue is whether the Commission can properly de-emphasize these factors

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[36] App. at 106a. *See* Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm., 341 U.S. 329 (1951). Under the NGA, the Commission's sales jurisdiction extends only to sales for resale. *Panhandle* involved an exercise by the states of their authority to regulate direct sales, that is, sales for ultimate consumption. By contrast, the Commission's jurisdiction over interstate transportation is plenary. The Commission has ruled that the transportation and delivery of gas by an interstate pipeline to a customer is not "local distribution" of natural gas subject to state jurisdiction Mojave Pipeline Co., 35 F.E.R.C. (CCH) ¶ 61,199 (1986), *rehearing denied*, 41 F.E.R.C. (CCH) ¶ 61,040 (1987), *appeal pending*, Public Utilities Comm. on California v. FERC, No. 87-1679 (D.C. Cir.).

where the applicant has agreed to accept conditions which subject new services to the discipline of the marketplace. The resolution of the issue properly before the Court does not depend on the existence *vel non* of state regulatory authority.

CONCLUSION

The petitions for a writ of certiorari in Nos. 87-978 and 87-1091 should be denied.

Respectfully submitted,

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March 16, 1988

SUPPLEMENTAL APPENDIX
TO
BRIEF IN OPPOSITION

Letter to Honorable Frank Horton, from Acting FERC Chairman Anthony G. Sousa, April 23, 1986

SUPPLEMENTAL APPENDIX

FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

April 23, 1986

Honorable Frank Horton
House of Representatives
Washington, D.C. 20515

Dear Mr. Horton:

Thank you for your letter of March 18, 1986, in which you expressed your concern about the effect of take-or-pay provisions in natural gas contracts and the Commission's issuance of Order No. 436. Your letter posed eight questions to me regarding take-or-pay. My response to your inquiry is as follows.

(1) Are we correct that the FERC, and its predecessor the FPC, required a showing of a long term supply of gas as well as a long term market for the gas prior to authorizing transmission companies to construct and operate their proposed facility?

Under section 7(c) of the Natural Gas Act (NGA), pipeline companies seeking to initiate service or seeking to serve major new markets must show that their source(s) of supply are adequate to meet the needs of the new or expanded market. One measure of gas supply is "deliverability life," expressed in terms of the number of years a pipeline can meet its current annual requirements using the relevant source(s) of supply, given the certificated delivery capacity of the pipeline. Until the late 1960's, pipelines seeking Commission authorization to commence new or expanded service were required to show that their source(s) of supply had a minimum twelve-year deliverability life. The Commission adopted a more flexible policy in 1967, (18 C.F.R. § 2.61) which

had the effect of eliminating the requirement of a specific deliverability showing where (a) a pipeline had active gas procurement operations and (b) a pipeline's system extended into active production areas. The Commission's current policy is to review all applications for new or expanded service filed under section 7(c) of the NGA on a case-by-case basis to determine if an adequate supply of gas is available to support the application.

(2) Are we correct in assuming that your regulations require that the pipelines sell the gas to their distributor company customers at the same price that they buy it from the producers plus the cost of transportation from the production area to the market area?

Generally, a pipeline is not permitted to sell gas for more than the purchase price. Furthermore, under section 601 of the Natural Gas Policy Act of 1978 (NGPA), pipelines are guaranteed the right to passthrough their purchased gas costs to their customers to the extent the amount paid is just and reasonable and not excessive due to fraud, abuse, and similar grounds. Also included in a pipeline's cost of service are costs attributable to production, storage and transmission.

(3) Do most of the contracts between pipeline companies and the producers contain take-or-pay clauses?

Contracts for the sale of natural gas have traditionally contained provisions requiring the purchaser to take-or-pay for specified quantities of gas and the vast majority of current gas contracts contain take-or-pay provisions. Most contracts also contain a 5-year make up period in which producers are obligated to maintain the ability to deliver the gas paid for but not taken.

(4) What is the *current* magnitude of these liabilities?

The data submitted under our current regulations do not provide sufficient information to assess the current magnitude of these liabilities.

It is important to distinguish between actual prepayments made for gas not taken and a pipeline's potential take-or-pay liability under its contracts. Payments made before the expiration of the make up period are prepayments. Prepayments are treated as an asset of the pipeline and are added to the pipeline's rate base, along with any interest incurred by the pipeline to finance its prepayments. In some cases, a pipeline may not be able to market its prepaid gas during the make up period and, since prepayments are not purchased gas costs, the pipeline cannot automatically passthrough its prepayments.

A pipeline's take-or-pay liability is not suspectible to accurate estimate, because it is difficult to estimate the extent to which a pipeline will be unable to take gas during the make up period for which it has already paid or will be required to pay, and therefore for which it may become legally "liable." In addition, estimates are based on current levels of purchases and projected market demand, each of which may change during the make up period. Some pipelines include a discussion of their take-or-pay problems in their annual reports and Form 10-K quarterly reports filed with the Securities and Exchange Commission (SEC). As of November 1985, actual take-or-pay prepayments included in the rate base of major pipelines totalled approximately $650 million as computed by the FERC.

(5) It is our understanding that there is a significant delay between the time a pipeline incurs this liability and when they make payments. If this is correct, explain this delay. How does your response to question four above recognize this delay, if in fact it occurs?

Typical take-or-pay clauses define the "take" requirement in terms of a specific volume of gas which must be taken by the pipeline within a specific period of time, usually the contract year. The Commission does not impose specific reporting requirements on pipelines to moni-

tor take-or-pay payments and may learn of a pipeline's prepayments for the first time when a pipeline attempts to recover its costs and files its next rate case. Nothing in the Commission's regulations prevents a pipeline from making take-or-pay payments as soon as it contractually incurs them. To some extent, the estimates provided in response to question number four reflect this delay. To a greater extent, however, the imprecise quantification of take-or-pay liability can be traced to the historic and present reluctance of both pipelines and producers to make this information available, especially with respect to gas purchase contracts for gas not subject to the Commission's jurisdiction.

(6) In your notice of RM85-1 did you solicit information on current magnitudes of pipeline take-or-pay exposures? Was it provided with any degree of specificity? Does the Commission have any data on the extent to which Order Nos. 380 and 436 will increase pipelines' take-or-pay exposure? If so, what does this data reflect?

Over the last four years, the Commission has initiated several rulemaking proceedings in which take-or-pay has been an issue. In two recent proceedings (Docket Nos. RM85-1-000 and RM86-3-000), various members of the different segments of the industry have presented conflicting views on the magnitude of the take-or-pay problem.

At the moment, there are no data on the extent to which Order No. 436 may increase pipelines' take-or-pay exposure. We do know that take-or-pay prepayments have remained stable or declined slightly between 1982 and 1985.

(7) It is our understanding that the pipelines have not overwhelmingly availed themselves of Order No. 436 provisions. Please furnish the names of those companies who have availed themselves of the provisions. Has the implementation of the open access provision by these com-

panies been acceptable to their customers and their traditional suppliers? What impact has pipelines' increased take-or-pay exposure had on their decision to operate under Order No. 436?

The following companies have made blanket certificate or rate settlement filings under Order No. 436: Gas Gathering Corporation, Valley Gas Transmission, Inc., Mid Louisiana Gas Company, Columbia Gulf Transmission Company, Columbia Gas Transmission Corporation, Ozark Gas Transmission System, Gas Transport, Inc., Valero Interstate Transmission Company, Consolidated Gas Transmission Corporation, Erie Pipeline System, Seagull Interstate Corporation, Texas Eastern Transmission Corporation, Superior Offshore Pipeline Company, Northern Border Pipeline Company, Transcontinental Gas Pipeline Company, Transco Offshore Gathering Company, Transwestern Pipeline Company, and El Paso Natural Gas Company. In addition, many of these companies and others have provided self-implementing transportation services on an interim basis under Order No. 436 and section 311 of the Natural Gas Policy Act of 1978.

Since companies have only recently begun to transport gas pursuant to Order No. 436, it is too early to determine whether their participation has been acceptable to their customers and their suppliers. It is also difficult to determine whether and to what extent take-or-pay exposure has influenced pipelines' decisions on participation in Order No. 436.

(8) Are you aware of any pipeline companies whose financial abilities may be impaired by take-or-pay liabilities?

It is difficult to determine whether any pipelines have been financially impaired because of their take-or-pay liability. This may be discussed in filings made by pipe-

line companies with the Securities and Exchange Commission and in annual reports.

I hope this information is helpful to you. If I can be of further assistance to you in this or any other Commission matter, please let me know.

Sincerely,

/s/ Anthony G. Sousa
ANTHONY G. SOUSA
Acting Chairman

(5) (4) (5) (4) (5)

Nos. 87-976, 87-977, 87-978, 87-979, and 87-1091

In the Supreme Court of the United States

OCTOBER TERM, 1987

Supreme Court, U.S.
FILED
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JOSEPH F. SPANIOL
CLERK

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

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ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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3

QUESTIONS PRESENTED

1. Whether, upon determining that interstate natural gas pipelines were engaging in an unduly discriminatory and anticompetitive practice by refusing to provide transportation services to companies that choose to purchase natural gas from producers and other sellers rather than from the pipelines themselves, the Federal Energy Regulatory Commission correctly concluded that it had the statutory authority to eliminate such unlawful discrimination by requiring pipelines that transport gas under certain expedited regulatory procedures to offer transportation service on an "open access" basis.

2. Whether the court of appeals properly remanded to the Commission, for further consideration and explanation, the Commission's decision to take no action at this time with respect to the "take-or-pay" provisions in contracts between natural gas producers and interstate pipelines.

3. Whether the Commission acted within its statutory authority in establishing an optional expedited certificate procedure to ease regulatory barriers that would otherwise obstruct the provision of new pipeline services.

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-128a) is reported at 824 F.2d 981.[1] The orders of the Federal Energy Regulatory Commission are reported at 50 Fed. Reg. 42408 (1985); as corrected, 50 Fed. Reg. 45907 (1985); on reh'g, 50 Fed. Reg. 52217 (1985), 51 Fed. Reg. 6398, 11566, and 11569 (1986).

JURISDICTION

The judgment of the court of appeals was entered on June 23, 1987, and petitions for rehearing were denied on September 15, 1987. The petitions for a writ of certiorari in Nos. 87-976, 87-977, 87-978, and 87-979 were filed on December 14, 1987. The petition for a writ of certiorari in No. 87-1091 was filed on December 11, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

A. Statutory and Regulatory Background

1. The Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, gave the Federal Energy Regulatory Commission comprehensive regulatory authority over companies that engage in either the sale of natural gas for resale or the interstate transportation of natural gas. That authority extends to both gas producers, which produce and sell natural gas, and natural gas pipelines, which transport and sell natural gas.

The Commission regulates market entry through its authority under Section 7 of the NGA, 15 U.S.C. 717f, to issue certificates of public convenience and necessity, subject to such conditions as the Commis-

[1] "Pet. App." refers to the joint appendix to the petition for a writ of certiorari in No. 87-976.

sion deems appropriate, authorizing natural gas companies to transport or sell gas. The Commission regulates market exit through its authority to grant permission to abandon certificated service (see 15 U.S.C. 717f(b)). In addition, under Sections 4 and 5 of the NGA, 15 U.S.C. 717c and 717d, the Commission regulates the price and other terms of jurisdictional sales and transportation, ensuring that the rates and charges for such service, as well as all rules, regulations, practices, and contracts affecting those rates and charges, are just and reasonable (see 15 U.S.C. 717c(a)).

Section 4(b) of the NGA prohibits natural gas companies from granting "any undue preference or advantage" or maintaining "any unreasonable difference in rates, charges, service, * * * or in any other respect * * *" (15 U.S.C. 717c(b)). Section 5(a) directs the Commission to exercise its remedial authority to eliminate rates or practices that are "unjust, unreasonable, unduly discriminatory, or preferential" (15 U.S.C. 717d(a)). Finally, the Act requires the Commission to evaluate and remedy any anticompetitive behavior by natural gas companies. *E.g.*, *FPC* v. *Conway Corp.*, 426 U.S. 271, 278-279 (1976).

2. Congress altered the operation of the NGA in 1978 when it adopted the Natural Gas Policy Act (NGPA), 15 U.S.C. 3301 *et seq.* That statute was designed "to give market forces a more significant role in determining the supply, the demand, and the price of natural gas." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 422 (1986); see also *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983) (the NGPA "comprehensively and dramatically" changed the scheme of regulation under the Natural Gas Act).

The NGPA eliminated price regulation of sales of "new" gas, substituting a single scheme of statutory ceiling prices for wellhead sales ("first sales") of natural gas (15 U.S.C. 3301-3333) and a timetable for the gradual decontrol of all wellhead sales (15 U.S.C. 3331). The statute also removed deregulated gas from certificate and abandonment requirements imposed by the Natural Gas Act.[2]

The NGPA also modified regulation of pipelines under the NGA. Section 311(a) of the NGPA, 15 U.S.C. 3371(a), creates an alternative regulatory framework for gas transportation that is designed to promote the development of a unified pipeline transportation network. See H.R. Rep. 95-543, 95th Cong., 2d Sess. 47 (1977). The provision states that the Commission "may" allow interstate pipelines and intrastate pipelines to transport gas for each other, as well as for local distribution companies; any transportation permitted by the Commission under Section 311 is exempted from the certificate and abandonment requirements of the Natural Gas Act (15 U.S.C. 3431 (a)(2)). Section 311 transportation remains subject to the Commission's ratemaking authority (15 U.S.C. 3371(a)(1)(B)) as well as to "such terms and conditions as the Commission may prescribe" (15 U.S.C. 3371(c)).

This revamped statutory scheme has led to a restructuring of the natural gas industry. Prior to the adoption of the NGPA, interstate natural gas pipelines functioned primarily as merchants, buying gas from producers at the "wellhead" and then transporting that gas for resale to the pipelines' customers—

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[2] Section 601 of the NGPA, 15 U.S.C. 3431, coordinates the provisions of the NGPA with the Commission's regulatory authority under the NGA.

local distribution companies that buy gas at wholesale for subsequent resale and large "end users" that buy gas at retail for their own consumption. See Pet. App. 17a; Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 346, 348 (1983). Since the adoption of the NGPA, however, pipelines have increasingly provided "unbundled" transportation services: local distribution companies and end users buy gas directly at the wellhead from producers and other sellers; the pipelines' role is to transport this "third-party" gas from seller to buyer.

Pipelines generally have provided these transportation services under one of several streamlined authorization procedures that replaced the traditional—and more time-consuming—Section 7(c) certificate proceeding and were designed by the Commission to give pipelines increased flexibility in the provision of transportation services. Under Section 311, the Commission has authorized interstate and intrastate pipelines to provide certain categories of transportation service on a "self-implementing basis"; a pipeline receives a blanket authorization for the provision of transportation services that eliminates the need for advance Commission approval of individual transactions. See 44 Fed. Reg. 52179 (1979). The Commission has established similar streamlined procedures for other categories of transportation services pursuant to its authority under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c). See, *e.g.*, 48 Fed. Reg. 34872 (1983).

B. Order No. 436

1. In early 1985, the Commission published two notices of inquiry stating its intent to explore solutions to certain problems in the provision of trans-

portation services. 50 Fed. Reg. 114 (1985); 50 Fed. Reg. 3801 (1985). One concern identified by the Commission was the pipelines' refusal in certain circumstances to transport third-party gas. Pipelines generally provided this service only to customers capable of switching to alternative fuels. As a result, so-called "captive customers" were generally unable to buy gas at the wellhead because the pipelines would not provide the transportation service needed to move the gas from the seller to the buyer.

Due to a growing surplus in the gas supply in recent years, the price of gas at the wellhead has fallen; the price of gas sold by pipelines, by contrast, has remained relatively high. In response to customers' efforts to obtain transportation services for third-party gas purchased at the wellhead, pipelines have segmented their market: pipelines generally have provided third-party gas transportation services only to those "fuel-switchable" customers that would otherwise leave the pipeline entirely; the pipelines offered sales service—but not transportation service—to the captive customers forced to purchase gas from the pipeline because they could not switch to another fuel source. Pet. App. 20a-23a.

Several months after the Commission issued the notices of inquiry, the United States Court of Appeals for the District of Columbia Circuit vacated and remanded orders establishing two of the Commission's alternative transportation programs. The court held that the Commission had failed to respond adequately to contentions that those programs were unduly discriminatory because transportation services were available only to fuel-switchable customers and not to captive customers. *Maryland People's Counsel* v. *FERC*, 761 F.2d 768 (D.C. Cir. 1985); *Maryland People's Counsel* v. *FERC*, 761 F.2d 780 (D.C. Cir.

1985). Shortly thereafter, the Commission issued a notice of proposed rulemaking proposing to adopt a new rule governing pipelines' authority to provide transportation services (50 Fed. Reg. 24130 (1985)).[3]

2. In October 1985, the Commission adopted Order No. 436, which comprehensively altered regulation of pipeline transportation to take account of the competitive forces unleashed by the NGPA (50 Fed. Reg. 42408). The Commission found that as a result of changes in the natural gas industry accelerated by the removal of price controls mandated by the NGPA, "natural gas has become a separate and distinct economic *commodity* * * * distinct from transportation and distinct from [other pipeline services]" (*id.* at 42412 (emphasis in original)). It stated that the elimination of price regulation of first sales of most natural gas resulted in a "generally competitive market" in that commodity (*id.* at 42413).

The Commission further found that significant changes had taken place with respect to interstate pipeline transportation of natural gas: in some markets two or more pipelines competed against one another; in other markets, however, there remained only a single pipeline supplier. In addition, "the maturing of the pipeline industry in recent decades has meant that there is now an interconnected nationwide pipeline grid" (50 Fed. Reg. 42412 (1985)). The result of these changes was "[a] highly integrated *transportation* network, highly monopolistic in some markets,

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[3] The D.C. Circuit stayed its mandates in the two *Maryland People's Counsel* cases to allow transportation service to continue until the Commission completed the rulemaking proceeding that culminated in the rule at issue in the present case. *Maryland People's Counsel* v. *FERC*, 768 F.2d 450 (D.C. Cir. 1985); *Maryland People's Counsel* v. *FERC*, 768 F.2d 1354 (D.C. Cir. 1985).

fairly competitive in others; over which Congress has generally determined to retain utility-type regulation over market entry, exit and price; but for which Congress has also allowed an alternative approach [under NGPA § 311] in which there may be no restrictions as to market entry and exit, but for which Congress expressly retained regulation as to rates" (*id.* at 42413 (emphasis in original)).

The Commission concluded that it was appropriate to continue regulatory supervision over transportation services, but to do so in a manner that allowed the commodity market for natural gas to develop in a competitive fashion. "In this way, regulation will allow competitive forces to operate in those areas where Congress has determined they will better protect the public interest than traditional utility-type regulation, while retaining the traditional-type regulation in those areas where competitive forces have been found inadequate by the Congress" (50 Fed. Reg. 42413 (1985)).

The Commission also found that natural gas purchasers "seeing the availability of supplies in the field at [lower] prices * * * are seeking to purchase gas directly in the field and have it transported to [them] * * * in competition with the system supplies which the pipeline retains under certain uneconomic long-term contracts" (50 Fed. Reg. 42421 (1985) (footnotes omitted)). However, "pipelines have generally expressed a reluctance to provide these transportation services on a non-discriminatory basis to their existing sales customers or to customers without immediate fuel-switching capability"; they provided such services only to customers capable of abandoning the pipeline in favor of an alternate fuel source (*ibid.* (footnote omitted)). The Commission determined that this discrimination in the provision of transpor-

tation services "impeded the ability of natural gas consumers to secure the rewards of competition in natural gas markets commensurate with the[ir] risks"; in particular, the Commission concluded that consumers had been deprived of the benefit of lower field prices for natural gas because they were unable to obtain transportation for that lower-priced gas. *Ibid.*; see also *id.* at 42424 ("permitting pipelines to unduly discriminate or to exclude certain consumers from transportation services is inconsistent with the fundamental goals of consumer protection and competition in the Natural Gas Act and the Natural Gas Policy Act").

In order to remedy this problem, the Commission consolidated its various alternative transportation procedures into two streamlined procedures: pipelines were authorized to transport gas without prior Commission approval either under Section 311 of the NGPA or under a "blanket certificate" issued under Section 7(c) of the NGA. However, the Commission imposed an "open-access" condition upon pipelines obtaining blanket certificates or providing Section 311 transportation: such pipelines must provide transportation service "without undue discrimination, or preference" (18 C.F.R. 284.8(b)). This condition was designed to prevent pipelines from refusing to transport third-party gas purchased from a seller competing with the pipeline. See 50 Fed. Reg. 42421, 42424-42425, 42430 (1985).

The Commission examined and rejected claims, advanced mainly by pipelines, that the open-access condition exceeded the Commission's authority because it transformed pipelines into common carriers. The Commission concluded that the open-access condition was merely an exercise of the Commission's authority, under Sections 4 and 5 of the NGA, to remedy

undue discrimination and anticompetitive behavior.[4] The Commission stressed that the open-access condition extended only to pipelines that made use of the blanket "self-implementing" authority to provide transportation services set forth in Section 311 of the NGA and the Commission's rules under Section 7(c); the condition does not automatically apply to traditional Section 7(c) certificates authorizing individual transactions. The Commission stated that in the latter situation it would consider on a case-by-case basis whether the open-access condition was necessary to remedy undue discrimination and anticompetitive behavior. The Commission further concluded that, because the open-access condition applied only to those pipelines that chose to utilize the self-implementing transportation authority, it was voluntary, and therefore did not amount to a common carriage obligation. 50 Fed. Reg. 42426-42428 (1985).[5]

The Commission rejected claims that the open-access condition should not be imposed because it would reduce sales of gas by pipelines and therefore increase pipelines' liability to producers under contractual take-or-pay provisions.[6] In the Commission's

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[4] The Commission also found that its broad power to impose conditions upon the provision of transportation services under Section 311 of the NGPA justified the open-access condition. See 50 Fed. Reg. 42428 (1985).

[5] The Commission also adopted ratemaking principles designed to encourage pipelines to offer transportation services on a nondiscriminatory basis (50 Fed. Reg. 42447-42455 (1985)) and required pipelines making use of the blanket transportation authority to allow their customers to adjust contractual obligations to purchase gas from the pipeline (*id.* at 42438-42447). The latter provision allows pipeline gas-purchase customers to obtain transportation service while purchasing gas from other sources.

[6] "Take-or-pay" costs can result when the pipeline's contract with its supplier provides that the pipeline will take a

opinion these contractual problems could be settled among the parties in individual cases and did not justify continuation of unduly discriminatory transportation practices that deprived consumers of access to competitively priced gas. 50 Fed. Reg. 42462-42465 (1985).

Finally, the Commission established an "optional expedited certificate" (OEC) procedure to expedite the issuance of certificates of public convenience and necessity for new pipeline facilities and services pursuant to Section 7 of the NGA (see 50 Fed. Reg. 42467-42476 (1985)). The Commission indicated that the certification process could constitute a barrier to entry into the market for the provision of transportation services. The new procedure is "designed to provide consumers with greater options in the array of gas services available by giving pipelines the ability to offer new service and construct facilities on a timely basis" (*id.* at 42467). The Commission found that, by removing an obstacle to competition, the new procedure would stimulate efficiency in the construction of pipeline facilities and competition in the provision of services to pipeline customers (*ibid.*).

Under the procedure established by the Commission, certificates issued on an expedited basis are sub-

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particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take-or-pay" payments to its supplier. If the pipeline does incur take-or-pay costs, these costs generally may be included in the pipeline's rate base; the take-or-pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take-or-pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it has the opportunity to recover prudently incurred take-or-pay costs.

ject to conditions designed to ensure that the economic risk of the project is borne solely by the pipeline and not by ratepayers (see Pet. App. 96a n.32 (summarizing conditions)). In return, the applicant gains the benefit of a rebuttable presumption that the project meets the "public convenience and necessity" standard of Section 7, which obviates the need for a hearing in most cases. Parties who contest the application must raise genuine issues of material fact in order to obtain a hearing. See 18 C.F.R. 157.104.

C. The Decision of the Court of Appeals

The court of appeals upheld most elements of Order No. 436, including the open-access condition and the expedited certificate procedures. As to certain specified issues—including the take-or-pay question—the court directed the Commission to reconsider its determinations. See Pet. App. 1a-128a.[7]

The court of appeals unanimously upheld the factual findings underlying the Commission's order. The court observed that the Commission had found "(a) that pipelines continue to possess substantial market power; (b) that they have exercised that power to deny their own sales customers, and others without fuel-switching capability, access to competitively priced gas; and (c) that this practice has denied consumers access to gas at the lowest reasonable rates" (Pet. App. 30a (citations omitted)). And it found these findings basically unchallenged by the parties seeking to overturn the Commission's order. Indeed, the court observed that the pipelines' claim that the order would prevent pipelines from passing

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[7] The court also remanded issues raised by the Commission's decisions to allow customers to adjust their contractual levels of service and to grandfather certain pre-existing transportation arrangements (Pet. App. 123a-124a).

on their own gas purchase costs "tends to substantiate the Commission's views (1) that in the absence of Order No. 436 competition will be thwarted and (2) that the practices controlled by Order No. 436 are indeed anticompetitive and discriminatory" (*id.* at 31a).

The court unanimously rejected the contention that the Commission lacked the statutory authority to impose the open-access condition upon its blanket authorizations for the provision of transportation services. Turning first to the Commission's authority under the Natural Gas Act, the court found that the Commission's broad power to eliminate discriminatory practices authorized the imposition of the open access condition and that this power was not diminished by the fact that the condition bears some resemblance to obligations imposed upon common carriers (Pet App. 25a-34a). The court also found that the Natural Gas Policy Act empowers the Commission to "control discrimination where the effort imposes on pipelines a duty—even though it be a conditional one—equivalent to the common carrier's duty to provide nondiscriminatory service" (*id.* at 35a).

The court of appeals remanded the "take-or-pay" issue to the Commission for further consideration. Various parties argued in the court of appeals that the provisions of Order No. 436, including the open-access condition, would have the effect of decreasing pipelines' gas sales and thereby increasing pipelines' exposure to contractual liability to producers under take-or-pay provisions. These parties asserted that the Commission had failed to give reasoned consideration to a number of potential solutions to this problem.[8] The court of appeals agreed, and directed the

[8] In concluding that the Commission had failed to give reasoned consideration to claims that the open-access condi-

Commission to reconsider the matter. Pet. App. 75a-95a. The court declined to "require that FERC reach any particular conclusion" with respect to this issue, stating that it "merely mandate[d] that [the Commission] reach its conclusion by reasoned decision-making" (*id.* at 94a).[9]

The optional expedited certificate procedure was challenged on a number of grounds in the court of appeals. The court declined to address claims relating to the procedures for the application of the OEC rules, holding that those issues were not ripe for review (Pet. App. 97a-102a).

The court did address the challenges to the Commission's determination that certificate proposals conforming with the rules would be treated as presumptively consistent with the public convenience and necessity; the court upheld this determination by a

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tion would impede the settlement of take-or-pay liability by pipelines and producers the court rejected (Pet. App. 81a) the Commission's reliance on the "voluntary" nature of the open-access condition, holding that the use of the blanket transportation authority might be mandatory for some pipelines.

[9] Judge Mikva dissented with respect to this point, stating (Pet. App. 126a) that the Commission should be required on remand to take some affirmative action to assuage the take-or-pay problem.

Following the court of appeals' remand, the Commission issued an interim rule addressing the issues remanded by the court of appeals, including the take-or-pay problem. See 52 Fed. Reg. 30334 (1987), on reh'g, 52 Fed. Reg. 39630 and 48986 (1987), petitions for review pending, No. 87-4749 (5th Cir. filed Oct. 19, 1987), No. 87-1588 (D.C. Cir. filed Oct. 19, 1987). (Motions to resolve the venue question are now pending before the Fifth Circuit.) At the time it issued the interim rule, the Commission also solicited public comments regarding the appropriate final rule with respect to these issues (see 52 Fed. Reg. 30351 (1987)).

divided vote. The court first rejected the claim that the Commission's presumption "disregards important factors that Congress intended the Commission to consider" in the certification process (Pet. App. 102a). One of the purposes of certification is to " 'prevent uneconomic extensions and waste' " that would burden utilities' ratepayers (*id.* at 103a (footnote and citations omitted)). The court of appeals found that this purpose was not implicated by the presumption, because the presumption may be invoked only where a pipeline's investors bear all of the financial risks of the project; ratepayers cannot be affected adversely by such a project (*id.* at 103a-104a).

The court next concluded that the presumption did not improperly preclude consideration of the possibility that a new service might adversely affect existing firms and their captive customers. The court found that, under the Commission's criteria, applicants were likely to seek to enter a market in which the incumbent firm could lose customers only if the incumbent was inefficient or engaging in price discrimination, because that is the only context in which the applicant could be assured of recouping its investment. "If incumbent-firm inefficiency or price discrimination is the explanation, then certification will result in losses for a firm that, so far as appears, deserves to lose." Pet. App. 104a.

The court noted that in the case of an application to provide services in competition with a local distribution company such "deserved losses" may "ultimately fall not on [the distribution company's] shareholders but on its remaining customers—most notably its captive residential consumers," but it rejected arguments that the Commission's presumption violated congressional intent to the extent that it creates a risk that the local distribution company will be "bypassed" by a competitor (Pet. App. 105a).

First, the court accepted the Commission's view that the risk of bypass is "slight" because the distribution company will be free to compete in the market for the provision of transportation services, thus retaining the ability to earn a return on its fixed costs (*id.* at 105a-106a). Second, state authorities have power to regulate essentially local aspects of a bypass under this Court's decision in *Panhandle Eastern Pipe Line Co.* v. *Michigan Public Service Comm'n*, 341 U.S. 329 (1951). The court of appeals stated that that authority, and other options available to the states, would allow states to protect captive customers (Pet. App. 106a-107a). Finally, the court of appeals found that the Commission had adequately reconciled its decision in the present case with earlier decisions attempting to discourage bypass (*id.* at 111a-112a).[10]

ARGUMENT

Based on a comprehensive and detailed analysis of all aspects of Order No. 436, the court below upheld the substance of the order, remanding the matter to the Commission for further consideration of a limited number of specified issues. That thorough decision, upon which we rely, is correct and does not conflict with any decision of this Court or any other court of appeals. Review by this Court is not warranted.

1. The court of appeals held that the open-access condition of Order No. 436 was a proper exercise of the Commission's authority under Sections 4 and 5

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[10] Judge Mikva dissented, concluding that the OEC procedure would undermine the ability of state regulatory commissions to subsidize the rates charged to residential and commercial customers through higher rates to industrial users, "a matter of essentially local concern" (Pet. App. 127a). He also disagreed with the majority's conclusion that the Commission had adequately justified its change in policy concerning bypass (*id.* at 127a-128a).

of the NGA to remedy undue discrimination, and that this general authority was properly implemented through the Commission's broad power to impose conditions upon certificates of convenience and necessity issued under Section 7 and its power under Section 16 of the NGA to "prescribe * * * rules * * * necessary or appropriate to carry out the [NGA's] provisions" (15 U.S.C. 717*o*). Petitioners do not dispute either the existence of the practices the Commission found or the Commission's finding that they are unduly discriminatory; rather they claim (87-976 Pet. 7-17; 87-977 Pet. 5-20; 87-979 Pet. 12-26) only that the open-access condition is beyond the Commission's authority because it amounts to the imposition of common carrier status. That claim is without merit and was properly rejected by the court below.

a. The Commission's broad remedial authority under the Natural Gas Act fully supports the imposition of the open-access condition as a remedy for the unlawful discrimination found by the Commission. As the court of appeals observed (Pet. App. 26a), the Natural Gas Act "fairly bristles with concern for undue discrimination." Section 4(b) of the NGA, 15 U.S.C. 717c(b), states that pipelines are "prohibited," in "any transportation" under the Commission's jurisdiction, from (1) "grant[ing] any undue preference or advantage," (2) imposing any "undue preference or disadvantage," or (3) "maintain[ing] any unreasonable differences in rates, charges, services, facilities, or in any other respect." Where the Commission finds that any transportation "practice" by a pipeline is "unduly discriminatory" or "preferential," Section 5(a) of the NGA specifically authorizes—indeed, requires—the Commission to "determine" the practice "to be thereafter observed" by the pipeline (15 U.S.C. 717d(a)). The court below correctly

recognized that "in the NGA Congress * * * [gave] the Commission power to stamp out undue discrimination; it is precisely that power that the Commission has here sought to exercise" (Pet. App. 26a).

The Commission chose to eradicate the unlawful discrimination in this case through its power under Section 7(e) of the NGA, 15 U.S.C. 717f(e), to attach conditions to certificates of public convenience and necessity issued under Section 7(c), 15 U.S.C. 717f(c). Under the open-access condition, pipelines that accept a blanket certificate, and thereby gain the self-implementing authority to transport gas without obtaining prior Commission approval, must agree to provide that transportation service "without undue discrimination or preference." 18 C.F.R. 284.8 (b), 284.9(b). Because the Commission does not review particular transactions under a blanket certificate, the open-access condition provides a necessary "bond of protection" (see *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 385 (1959)) against the continuation of the pipelines' unlawful practices. With this carefully crafted measure, therefore, the Commission fulfilled its statutory responsibility to eliminate undue discrimination.

Nothing in the language of the NGA supports petitioner's claim that the open-access condition somehow falls outside the Commission's statutory authority to remedy discrimination. Petitioners instead base their argument entirely upon ambiguous legislative history. That effort, as the court of appeals noted, is "uphill" because " 'courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point.' " Pet. App. 25a (citation omitted); see also, *e.g.*, *United States* v. *Locke*, 471 U.S. 84, 95-96 (1985). And the history discussed by petitioners does not support their at-

tempt to restrict the Commission's express statutory authority (see Pet. App. 25a-26a).

The legislative history on which petitioners rely consists of congressional inaction: Congress several times considered, but failed to enact, provisions that would have imposed common carrier status on pipelines (Pet. App. 25a, 26a). As the court of appeals observed, the history at most provides "modest support" for the conclusion that Congress, having declined to impose such a generic rule itself, did not intend the Commission to impose common carrier status "at will" (*id.* at 26a). It suggests no reason at all why the Commission may not impose an open access condition in appropriate factual circumstances as a remedy for undue discrimination and anti-competitive behavior.

The open-access condition, by requiring that pipelines that provide certain transportation services must do so without undue discrimination, serves one of the same purposes as common carriage regulation (Pet. App. 25a-26a). But the open-access condition does not rest on any supposed general power to impose common carrier status but on the power to remedy discrimination under Sections 4, 5, and 7 of the NGA. Therefore, even assuming that Congress intended to preclude the Commission from mandating common carriage "at will," it does not follow that Congress also intended to preclude the Commission from imposing service obligations when necessary to remedy undue discrimination in the "extreme factual circumstances" (Pet. App. 30a) of this case.

Indeed, the legislative history suggests, if anything, that Congress withheld generic common carriage authority because the Commission's remedial authority under Sections 4 and 5 already provided a more precise regulatory tool that could be applied in appropri-

ate factual circumstances.[11] As the court of appeals observed (Pet. App. 26a-27a):

> The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress, in 1906 and 1914 and 1935 and 1938 itself, refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.

In sum, the legislative background relied upon by petitioners provides "weak—almost invisible—support" (Pet. App. 26a) for their attempt to read out of the statute the Commission's express authority to remedy undue discrimination. Because petitioners have failed to establish anything close to the "clearly

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[11] Petitioners attempt (87-976 Pet. 12; 87-977 Pet. 12; 87-979 Pet. 23) to find a statutory basis for their claim in Section 7(a) of the Natural Gas Act. That provision sets out particular circumstances in which the Commission may order pipelines to enlarge their facilities in order to provide new service. But the open-access condition does not require pipelines to enlarge their facilities; it imposes non-discriminatory transportation obligations *to the limits of a pipeline's capacity to provide service.* See Pet. App. 42a-46a (discussing methods of allocating capacity when a pipeline has more requests for service than it can provide). Nothing in Section 7(a) limits the Commission's authority to require pipelines to provide transportation over existing facilities on terms that are not unduly discriminatory or anticompetitive.

expressed legislative intent" needed to overcome "the plain language of the statute" (*American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 75 (1982)), the court of appeals properly upheld the Commission's interpretation of its statutory authority as reasonable. Pet. App. 34a, citing *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).[12]

b. The court of appeals also correctly concluded (Pet. App. 34a-39a) that Section 602(b)(2) of the NGPA, 15 U.S.C. 3432(b)(2), poses no barrier to the imposition of the open-access condition upon pipelines that transport natural gas under Section 311(b)(1) of that statute.[13]

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[12] Petitioner in No. 87-977 is mistaken in its claim (Pet. 7-8) that the court below expanded upon the Commission's own view of its authority by affirming the open-access condition while rejecting the Commission's justification that the condition was voluntary. The Commission, in responding to arguments that the open-access condition amounted to common carriage, first stated (50 Fed. Reg. 42427 (1985)) that the condition properly rested upon its statutory authority to remedy undue discrimination. Because the court affirmed on that basis (Pet. App. 24a-39a), it did not reach the question whether that condition might also be justified as voluntary. Rather, the court addressed the Commission's claim that Order No. 436 was voluntary in a different context and rejected it there for reasons that have nothing to do with the common carriage arguments (see page 14 & n.8, *supra*).

[13] Section 602(b), entitled "Effect on State laws," provides:

> No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—
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> (1) pursuant to any [presidential] order under section 3362(c) or section 3363(b), (c), (d), or (i) of this title; or
>
> (2) authorized by the Commission under section 3371(a) of this title.

The court held that Section 602(b) "was a congressional effort to protect § 311(a) from the consequences of pipeline concern that service thereunder would expose them generally to classification as common carriers, most likely by states, and thus to an unprecedented range of legal burdens" (Pet. App. 35a). Without such protection, pipelines might be discouraged from transporting gas under the NGPA, thus defeating "the accomplishment of Congress's purposes" (*id.* at 35a-36a).[14] The court found no indication in the overall statutory scheme of the NGPA that Section 602(b) was intended to limit the Commission's authority to regulate transportation activities under Section 311. Indeed, Section 311(c) specifically states that transportation under that provision "shall be under such terms and conditions as the Commission may prescribe" (15 U.S.C. 3371(c)). To the extent Section 602(b) is relevant at all, it is because Congress foresaw the possibility that the Commission might exercise Section 311(c) authority to impose conditions resembling common carriage. Section 602(b) affirmatively protects a pipeline that decides to provide transportation under those conditions from any possibility that its actions might trigger the imposition of common carrier status under other statutes.

The structure of Section 602(b) supports this interpretation. The provision contains parallel subsections that protect pipelines from common carriage laws "by reason of any transportation" under either (1) presidential orders in emergency situations (see 15 U.S.C. 3432(b)(1)) or (2) Commission authori-

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[14] The court noted (Pet. App. 36a) that "[t]hough we have not identified similar federal hazards, we believe that Congress might well have included the reference to federal law out of anxiety that some overlooked federal provision would operate to thwart § 311's purposes."

zation under Section 311(a) (see 15 U.S.C. 3432 (b)(2)). Noting that "[t]he President's emergency powers are extremely broad," the court below found it "hardly credible that § 602 would stand in the way" of the imposition by the President of duties similar to common carriage if such action were necessary in emergency conditions. "By the same token, that section must not flatly bar the Commission from imposing similar conditions on gas transportation under § 311." Pet. App. 37a.[15]

c. Contrary to petitioners' assertions (87-976 Pet. 7-9, 12-14; 87-977 Pet. 10-14; 87-979 Pet. 9-12, 21-26), no decision of this Court or of another court of appeals conflicts with the determination of the court below that the Commission has the authority to impose the open-access condition under the Natural Gas Act and the NGPA. The cases on which petitioners rely address attempts to impose common carriage-like requirements under other statutory schemes, none of which provided express statutory authority to remedy undue discrimination.

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[15] There is no basis for the claim (87-976 Pet. 14; 87-977 Pet. 9-10; 87-979 Pet. 6) that the Commission's interpretation of Section 602 in the present case conflicts with an earlier interpretation set forth in 44 Fed. Reg. 52179, 52180-52181 (1979). The matter before the Commission in the earlier case was a request that it compel interstate pipelines to provide transportation services to distributors under Section 311. The Commission found nothing in the statute or the legislative history indicating that it had authority to require the provision of such services. The Commission did not there address the issue in this case: the scope of its authority to require that pipelines *already providing* Section 311 transportation service do so without undue discrimination or anticompetitive behavior. Therefore, the Commission's determination in that proceeding does not conflict with its conclusion here (50 Fed. Reg. 42429 (1985)) that Section 602(b) "does not sweep so broadly as to license unduly discriminatory rates or practices."

First, petitioners err in relying (87-976 Pet. 7-9; 87-977 Pet. 5-6; 87-979 Pet. 9-12) upon this Court's decision in *FCC* v. *Midwest Video Corp.*, 440 U.S. 689 (1979). The Court held in that case that a rule promulgated by the Federal Communications Commission requiring operators of cable television systems to offer channels for public use was barred by Section 3(h) of the Communications Act, 47 U.S.C. 153 (h), which specifically prohibits the agency from treating broadcasters as common carriers. There is no such prohibition in either the Natural Gas Act or the NGPA. Moreover, *Midwest Video* did not present the central question posed here—whether such a rule might be justified as a remedy for unduly discriminatory and anticompetitive practices. For these reasons the question addressed in *Midwest Video* does not at all resemble the issue in this case. See Pet. App. 27a.

Petitioners also seek to rely (87-976 Pet. 13-14; 87-977 Pet. 10-14; 87-979 Pet. 17-23) upon a series of cases involving Commission authority under the Federal Power Act, 16 U.S.C. (& Supp. IV) 791a *et seq.* In *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973), this Court upheld a lower court decision that an electric utility had violated the antitrust laws by refusing to transmit or "wheel" electric power. The Court rejected the utility's claim that its actions were immune from the antitrust laws because they were subject to regulation by the Commission under the Federal Power Act, holding that the Act gave the Commission only "limited" authority to order wheeling and left enough room for voluntary action by the utility to warrant application of the antitrust laws. 410 U.S. at 373-375.

Otter Tail Power Co. is plainly distinguishable from the present case. To begin with, the Federal Power Act does not give the Commission certificate

and abandonment authority over the interstate transmission of electricity; there is accordingly no equivalent to Section 7 of the Natural Gas Act, upon which the Commission based the open-access condition in this case. Second, as the court of appeals observed (Pet. App. 28a), the legislative history of the Federal Power Act discussed by this Court in *Otter Tail Power Co.* is "materially different" with respect to common carriage. When it adopted that statute, Congress considered and rejected a provision that would have specifically empowered the Commission to order wheeling to further the public interest. See *Otter Tail Power Co.*, 410 U.S. at 374. As we have discussed, Congress did not specifically eliminate the power to impose common carriage-like requirements at the time that it adopted the Natural Gas Act.[16]

These factors also distinguish the various decisions of the courts of appeals concerning the scope of the Commission's authority to order wheeling under the Federal Power Act (see 87-976 Pet. 13 n.12; 87-977 Pet. 12-14; 87-979 Pet. 21-25). Moreover, none of those cases presented the question whether the Commission could order wheeling to remedy undue discrimination or anticompetitive behavior (see Pet. App. 28a-30a).[17] The decision in this case therefore

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[16] Petitioners in No. 87-979 argue (Pet. 18-20) that the legislative histories of the two statutes are identical, but they rely on the provisions of a 1935 bill that was never reported out of committee (see Pet. App. 25a). Because the entire bill simply died in committee without being reported, it is impossible to conclude that Congress intended to limit the Commission's broad remedial authority. This legislative history is plainly different from that of the Federal Power Act, where Congress specifically deleted the relevant provisions at the time it adopted the statute and explained that it was doing so in order to limit the Commission's authority.

[17] In *Florida Power & Light Co.* v. *FERC*, 660 F.2d 668, 677-678 (5th Cir. 1981), cert. denied, 459 U.S. 1156 (1983),

does not conflict with the decisions cited by petitioners.

2. Other petitioners, producers of natural gas, claim (87-978 Pet. 9-23) that the court of appeals erred in remanding Order No. 436 to the Commission for reconsideration of the take-or-pay issue. The court of appeals held (Pet. App. 94a) that the Commission failed to provide a sufficient explanation of its decision to take no affirmative action to alleviate problems allegedly caused by take-or-pay contracts. In the view of these petitioners (87-978 Pet. 12, 15-21), the Commission sufficiently explained that decision in Order No. 436 and the court should have affirmed. This claim does not justify review by this Court.

The question whether the Commission sufficiently considered the take-or-pay question in Order No. 436 has absolutely no significance beyond this case. Indeed, these petitioners appear to be motivated by concern that the Commission might adopt one of the proposed solutions to the take-or-pay problem that

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the court specifically reserved the question whether the Commission could order wheeling to remedy undue discrimination (see Pet. App. 27a-28a). In a somewhat different vein, the court in *New York State Electric & Gas Corp.* v. *FERC*, 638 F.2d 388 (2d Cir. 1980), cert. denied, 454 U.S. 821 (1981), held that, where Congress had specified certain procedural and substantive prerequisites before the Commission may order wheeling (see 16 U.S.C. (& Supp. IV) 824j, 824k), the Commission must satisfy those prerequisites before requiring wheeling as a remedy for anticompetitive behavior. The Natural Gas Act does not contain any procedural prerequisites applicable in the present case.

Finally, petitioner in No. 87-979 errs in claiming (Pet. 21-23) that the decision by the court of appeals in this case conflicts with the decision in *Central West Utility Co.* v. *FPC*, 247 F.2d 306 (3d Cir. 1957). That case involved limitations imposed by Section 7(a) of the Natural Gas Act; as noted above (see note 11, *supra*), that provision does not apply to the open-access condition.

the court of appeals directed the Commission to reconsider on remand. But the propriety of those solutions may be considered in review proceedings following the Commission's decision with respect to this question.[18]

3. Although the optional expedited certificate rules were challenged in the court of appeals by a large number of parties, only one local distribution company, Southern California Gas Company (SoCalGas), has raised the matter in this Court (No. 87-1091). And SoCalGas merely renews arguments that the court below properly rejected either on the merits or on the ground that the claims were premature and hypothetical.

a. SoCalGas argues, as it did in the court of appeals, that the Commission has "turn[ed] its back" on the standards of Section 7 of the Natural Gas Act by adopting a presumption that the public convenience and necessity will be satisfied if a proposal is structured in accordance with specified standards (87-1091 Pet. 5-7); that the OEC rules represent an unjustified and unexplained departure from the Commission's "historic policy" of discouraging pipelines from "bypassing" local distribution companies in order to directly serve industrial customers (*id.* at 7-9); and that the OEC rules are invalid because they will

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[18] Petitioners are mistaken in suggesting (Pet. 9, 17) that the mandate of the court of appeals binds the Commission's discretion on remand. On the contrary, the court below specifically declined to direct any particular course of action on remand (Pet. App. 92a, 94a) and expressly preserved the possibility that the Commission might reaffirm its decision regarding the take-or-pay issue (*id.* at 94a). Indeed, the latter aspect of the majority's decision drew a dissent from Judge Mikva who stated (*id.* at 126a) that the Commission should be required to take affirmative action respecting the take-or-pay issue.

require the Commission to approve such bypass arrangements without giving due consideration to the impact on captive customers (*id.* at 14-15). None of these claims has any merit and each was properly rejected by the court of appeals.

In the first place, as the court of appeals noted, it is "far too late in the history of administrative law" to suggest that a regulatory agency cannot establish by rulemaking the criteria it will apply in evaluating whether to grant certificate authority. Pet. App. 102a-103a n.34, citing *FPC* v. *Texaco Inc.*, 377 U.S. 33 (1964); *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192 (1956); and *National Tour Brokers Ass'n* v. *ICC*, 671 F.2d 528 (D.C. Cir. 1982).

The court of appeals thoroughly considered—and properly rejected—petitioner's challenges to the merits of the rule (see Pet. App. 102-111a). The court found (*id.* at 104a) that because the criteria selected by the Commission promote competition in the interstate transportation of natural gas, they must be viewed as "an experiment designed to realize the congressional scheme, not to defeat it." In addition, because the rules place all economic risk on the pipeline seeking the optional certificate, they do not depart from the Commission's traditional policy against bypass, which essentially sought to avoid burdening consumers with costs attributable to unnecessary duplication of facilities (*id.* at 111a-112a).

Finally, petitioner's claim that the rules preclude adequate consideration of the effects of bypass on "captive" customers is undercut by provisions in the rules themselves requiring actual notice by the OEC applicant to affected local distribution companies and state statutory agencies. 18 C.F.R. 157.102(b)(1)(iv). Moreover, the court of appeals found that re-

lief on a bypass claim might well be available from state regulators (Pet. App. 105a-111a).[19]

b. SoCalGas also argues (Pet. 9-10) that its complaints about the procedures set forth in the OEC rules—*i.e.*, that the rules impermissibly shift the burden of proof from the applicant to opposing parties, and that the presumption established by the rules will be "conclusive" in practice and not rebuttable—are ripe for review.

The court of appeals correctly determined, under the two-pronged test of *Abbott Laboratories* v. *Gardner*, 387 U.S. 136 (1967), that these procedural challenges are not ripe for review. First, by their very nature, complaints about burden of proof and the operation of presumptions will be better illuminated in a concrete factual setting. See Pet. App. 100a-101a. Furthermore, SoCalGas faces no immediate harm as a result of the postponement of review; nor is it called upon to change its "primary conduct" in reliance on the rules, see *Toilet Goods Ass'n* v. *Gardner*, 387 U.S. 158 (1967). See Pet. App. 101a-102a. There will be an opportunity, on review of any decision granting a certificate under the OEC procedure, for SoCalGas to challenge the Commission's application of the new rules.

In any event, SoCalGas's premise is false: the presumption established by the rules need not be "conclusive" (87-1091 Pet. 10). As the court of appeals stated (Pet. App. 109a (emphasis added)):

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[19] Moreover, this claim regarding the consideration to be devoted to bypass claims under the Commission's new procedures, like the other procedural challenges raised by petitioner, is best left for resolution until after the OEC rules are applied in a concrete factual situation. See pages 29-30, *infra*.

> the presumption created by the OEC procedures *is* rebuttable. We cannot know at this point precisely what will be necessary to persuade the Commission that application of the presumption is inappropriate. But the existence of that backdrop confirms our judgment that the OEC rules themselves can readily be applied in a manner consistent with the congressional purposes.

c. Petitioner also argues (87-1091 Pet. 11-14) that because the Commission and the court of appeals assumed that states retain authority to regulate local aspects of bypass under *Panhandle Eastern Pipe Line Co.* v. *Michigan Public Service Comm'n*, 341 U.S. 329 (1951), this Court should now "clarify" the exact scope of such state authority to ensure that a "regulatory gap" does not result from the OEC rules.

This Court held in *Panhandle* that a state regulatory commission could assert certificate authority over local facilities proposed by a pipeline company to directly serve industrial customers already being served by a local distribution company. SoCalGas would have this Court go much further, and provide guidance on the precise reach of state authority under *Panhandle*.[20] But this Court "do[es] not sit to decide hypothetical issues or to give advisory opinions about issues as to which there are not adverse parties before [it]." *Princeton Univ.* v. *Schmid*, 455 U.S. 100, 102 (1982).

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[20] The court of appeals acknowledged that the "exact scope" of the states' authority to regulate local aspects of bypass is "unplumbed," but concluded that the issue was not properly before the court, and that, in any event, the *Panhandle* case "clearly tends to undermine petitioners' assault on the Commission's refusal to except bypass situations from the OEC procedures, insofar as that assault turns on assumptions of total state incapacity to address the issue" (Pet. App. 106a).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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No. 87-978

IN THE
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OCTOBER TERM, 1987

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PETITIONERS' REPLY BRIEF

At base, the petition for a writ of certiorari in this docket (the "Producers' Petition"[1]) seeks review of a purely legal question of critical importance: Does the Federal Energy Regulatory Commission ("FERC" or the "Commission") have the statutory authority to abrogate producer-pipeline natural gas contracts merely because they contain take-or-pay provisions? For the most part, the briefs in opposition to the Producers' Petition do not contest the appropriateness of Court review of this issue. Instead, they stress arguments for postponing such review, all of which are without merit.

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[1] Petition for Certiorari, *Shell Offshore Inc. v. Associated Gas Distribs.*, No. 87-978 (filed Dec. 14, 1987). This petition was filed jointly by 21 natural gas producers.

1. FERC concluded in Order No. 436 that it lacked authority to modify or abrogate take-or-pay contracts, noting that proponents had advanced "[n]either the legal nor factual basis for . . . voiding . . . freely negotiated contracts." *See* Order No. 436, 50 Fed. Reg. 42408, 42423-24, 42433-34 (1985) (27a-28a, 55a-57a).[2] The Commission stressed the congressional determination in the Natural Gas Policy Act, 15 U.S.C. §§ 3301-3342, 42 U.S.C. § 7255 (1982) ("NGPA"), that pricing arrangements at the wellhead should be governed by market forces, Order No. 436, 50 Fed. Reg. at 42423 (26a-28a), and found that agency abrogation of producer-pipeline contracts would "raise extremely serious questions regarding the ability of private parties in the gas production industry to rely on private contracts as a tool for structuring basic economic relationships." *Id.* at 42423 (27a). As the court of appeals conceded, action that "essentially substitute[s] FERC price controls for the wellhead market [is] . . . clearly forbidden by the NGPA." *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 1022 n.26 (D.C. Cir. 1987) (P.A. 79a).[3]

FERC also rejected arguments "that the Commission has the authority to require producers to waive contractual rights under the take-or-pay provisions of existing contracts as a condition to obtaining non-discriminatory transportation." Order No. 436, 50 Fed. Reg. at 42433 (55a). The Commission concluded that it would be unduly discriminatory under section 5 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717d (1982), to deny pipeline access to producers merely because they decline to

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[2] Parenthetical references following citations to Order No. 436 are to page numbers in the Appendix submitted with the Brief in Opposition of Exxon Corporation and Conoco Inc. to the petitions for certiorari filed in Docket Nos. 87-976, 87-977, 87-979.

[3] References following citations to the decision below, *Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), are to the Appendix filed with the Producers' Petition and are designated "P.A."

forfeit contract rights. Order No. 436-A, 50 Fed. Reg. 52217, 52226 (1985). Refusal to provide transportation services in such circumstances "would discriminate not only against the producer-seller, but also against the willing buyer who has never been a party to the take-or-pay contract in the first place." *Id.* FERC believed, moreover, that with respect to nonjurisdictional gas (*i.e.*, gas not subject to regulation under the NGA), conditioning producer access in this fashion would have the effect of coercing producers "to take action which is beyond our power to compel." Order No. 436, 50 Fed. Reg. at 42433 (56a). For all of these statutory reasons, FERC declined "by essentially a stroke of the pen, to void thousands of gas purchase agreements nationwide and to declare worthless some $7 billion worth of contract damage claims." *Id.* at 42423 (27a).

On appeal, the D.C. Circuit, seemingly ignoring the Commission's statutory analysis on the point, ordered FERC to "reassess" its refusal to invoke its authority under NGA section 5 to set aside contracts with "troublesome" take-or-pay provisions. *See Associated Gas*, 824 F.2d at 1027-28 (P.A. 89a-91a). Further, the court explicitly rejected FERC's conclusion that it lacked authority to condition producer access to pipelines on the waiving of take-or-pay contract provisions, declaring that the relevant statutes pose "no barrier" to such agency action. *Id.* at 1030 (P.A. 94a). In so ruling, the court of appeals erred by failing to acknowledge "that considerable weight should be accorded to [FERC's] construction of [the] statutory scheme," and it impermissibly "substitute[d] its own [statutory] construction . . . for [the] reasonable interpretation made by" FERC. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).[4]

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[4] Contrary to the assertion of Tennessee Gas Pipeline Co. (Tenn. Gas. Opp. at 9 n.16), FERC's counsel has not "repudiated" the agency's view that it lacks statutory authority to abrogate take-or-

The opposition brief of Associated Gas Distributors, *et al.* ("AGD"), urges that the question presented is "unripe" for review under *Abbott Laboratories v. Gardner*, 387 U.S. 136, 148-49 (1967). (*See* AGD Opp. at 9.) But *Abbott* speaks only to the finality of administrative agency orders. Before the D.C. Circuit, the AGD group's arguments against FERC's statutory construction on the take-or-pay issue conceded the finality of Order No. 436, as do the separate pending certiorari petitions seeking review of other issues raised by that same FERC order.[5]

Equally unfounded is the contention by Tennessee Gas Pipeline Co. and AGD that when a court of appeals vacates an agency's determination on a point of statutory interpretation and remands the matter for further proceedings consistent with the appellate court's reading of the statute, it is premature for this Court to review the statutory construction question. (Tenn. Gas Opp. at 8-9; AGD Opp. at 9.) To the contrary, this Court has routinely reviewed statutory interpretation questions in just such circumstances. *See, e.g., Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983);

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pay contracts. Counsel merely argued that the agency's decision not to require contract abrogation could be upheld on other grounds. In any event, counsel's *post hoc* statements cannot supplant the rationale of the agency as set forth in Order No. 436. *See, e.g., Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168-69 (1962); *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943).

[5] Most of these petitions seek review of the question whether FERC is empowered to require nondiscriminatory pipeline access as a condition to authorizing certain transportation services. *See* Petitions for Certiorari, *Interstate Natural Gas Ass'n of America v. FERC*, No. 87-976 (filed Dec. 14, 1987); *Texas Eastern Transmission Corp. v. FERC*, No. 87-977 (filed Dec. 14, 1987); *City of Willcox, Arizona v. FERC*, No. 87-979 (filed Dec. 14, 1987). The assertion that this issue is ripe for review while the contract-abrogation question is not (*see* Tenn. Gas Opp. at 7) defies logic, since both issues arise from the same FERC order.

EPA v. National Crushed Stone Ass'n, 449 U.S. 64 (1980); *Southern Ry. Co. v. Seaboard Allied Mining Corp.*, 442 U.S. 444 (1979); *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978); *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978).

2. Although the Solicitor General does not join the argument that this Court is somehow barred from reviewing the contract-abrogation authority issue at this juncture, his opposition suggests that "the propriety" of whatever take-or-pay contract-abrogation policy FERC adopts on remand "may be considered in review proceedings following the Commission's decision." (S.G. Opp. at 27.) This observation reflects a misperception of the legal issue presented for review. That issue is whether the Commission has authority to abrogate producer-pipeline contracts (either by direct intervention or by requiring producers to waive contract rights as a condition of pipeline access), a question not open to further consideration by the Commission on remand. The Solicitor General's assertion that "the Commission might reaffirm its decision regarding the take-or-pay issue" (*id.* at 27 n.18) thus evades the question. The relevant point here is that in view of the D.C. Circuit's decision, FERC is not free to decline to order take-or-pay relief on the ground that it lacks authority to do so.[6] Without ques-

[6] Not surprisingly, shortly after the D.C. Circuit's decision, FERC issued an interim order (No. 500) which is already having the effect of abrogating take-or-pay contracts. Order No. 500, 52 Fed. Reg. 30334, 30338-41 (1987). FERC correctly reads the D.C. Circuit decision as establishing the existence of contract-abrogation authority and, correctly or incorrectly, as requiring FERC to exercise this authority immediately. The Commission has stated that "it has an *obligation* under *AGD* and related court orders to implement the interim procedures for [abrogating] take-or-pay" contracts. Order No. 500-C, 52 Fed. Reg. 48986, 48990 (1987) (emphasis added). In the view of FERC Commissioner Sousa, the D.C. Circuit has "stated in essence that open access transportation *should be* condi-

tion, the D.C. Circuit's ruling on the contract-abrogation issue "is fundamental to the further conduct of" proceedings in this area, and as such, that aspect of the decision below warrants immediate review by this Court. *United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945). *See also Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964); *Land v. Dollar*, 330 U.S. 731, 734 n.2 (1947).

3. The assertion by Tennessee Gas that NGPA section 601(c)(1), 15 U.S.C. § 3431(c)(1) (1982), is "irrelevant" to the question whether FERC may condition producer access to pipelines on the waiving of take-or-pay contract provisions ignores the readily apparent meaning of the statute. (*See* Tenn. Gas. Opp. at 14.) Section 601(c)(1) was intended to prevent the Commission from attempting to do indirectly what it is prohibited from doing directly—interfering with the wellhead pricing of natural gas. *See Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 221 (D.C. Cir. 1986) (NGPA legislative history indicates a concern with prohibiting "back door" regulation of producers). Under section 601(c)(1), the Commission "may not deny, or condition the grant of, any certificate" based on the amount to be paid so long as the price is "just and reasonable," 15 U.S.C. § 3431(c)(1) (1982), and in this case, the pricing provisions of the take-or-pay contracts are by statutory definition "just and reasonable."[7] The court of appeals conceded that its fundamental concern was that the freely negotiated take-or-pay contracts "provide for prices far in

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tioned on take-or-pay [contract-abrogation] relief" and, by issuing the mandate putting into effect the *AGD* decision below, has "approved" the contract-abrogation provisions already adopted by FERC in Order No. 500. Order No. 500-B, 52 Fed. Reg. 39630, 39633 (1987) (emphasis added).

[7] *See* NGPA § 601(b)(1)(A), 15 U.S.C. § 3431(b)(1)(A) (1982) (except in circumstances not relevant here, pricing provisions in producer-pipeline contracts "shall be deemed to be just and reasonable").

excess of current market levels." *Associated Gas*, 824 F.2d at 1021 (P.A. 75a). The conditioning of transportation access on producers' agreeing to abrogate those contracts is thus directly violative of section 601(c)(1)'s prohibition on pricing-based conditioning by FERC.[8]

4. The Court also has before it petitions for certiorari seeking review of the question whether FERC is empowered to require nondiscriminatory pipeline access as a condition to the authorization of certain transportation services. *See* p. 4 n.5 *supra*. The court of appeals correctly deferred to FERC's well-reasoned statutory analysis on this question, and review by this Court is not warranted.[9] Should this Court decide to review the nondiscriminatory access question, however, prompt review of the contract-abrogation issue would become even more critical. Both FERC and the D.C. Circuit held that the nondiscriminatory access issue could not be considered without simultaneous consideration of the contract-abrogation issue. *See* Order No. 436, 50 Fed. Reg. at 42422 (23a) (the issues are "inextricably related"); *Associated Gas*, 824 F.2d at 1044 (P.A. 124a) ("[t]he parts of Order No. 436 are interdependent"). Similarly, Petitioners respectfully submit that this Court should not address FERC's authority to impose the nondiscriminatory access condition as a means of furthering the goals of the NGA and NGPA without also determining whether the court of appeals' decision granting FERC authority to abrogate gas contracts undermines those very same statutes and their purposes.

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[8] Contrary to the contention of one opposition brief (Tenn. Gas Opp. at 14), Order No. 436 explicitly notes the substantive limits on FERC's authority imposed by NGPA section 601(c)(1). *See* Order No. 436, 50 Fed. Reg. at 42423 (28a) .

[9] *See* Oppositions to Petitions for Certiorari filed by Shell Offshore Inc. *et al.* (dated Feb. 19, 1988) and by Exxon Corporation and Conoco Inc. (dated Mar. 16, 1988) in Docket Nos. 87-976, 87-977, and 87-979.

For all of the foregoing reasons, a writ of certiorari should issue.

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